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Full contents
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GLOBAL AGENDA

POLITICS THIS WEEK

BUSINESS THIS WEEK

OPINION
Leaders
Letters

WORLD
United States
The Americas
Asia
Middle East & Africa
Europe
Britain
Country Briefings
Cities Guide

SURVEYS

BUSINESS
Management Reading
Business Education
Executive Dialogue

FINANCE & ECONOMICS
Economics Focus
Economics A-Z

SCIENCE & TECHNOLOGY
Technology Quarterly

PEOPLE
Obituary

BOOKS & ARTS
Style Guide

MARKETS & DATA
Weekly Indicators
Currencies
Big Mac Index

DIVERSIONS

RESEARCH TOOLS

CLASSIFIEDS

DELIVERY OPTIONS
E-mail Newsletters
Mobile Edition
RSS Feeds

ONLINE FEATURES
Cities Guide Go
Country Briefings Go
Audio interviews Go
Classifieds Go

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On the cover
The world's most valuable commodity is getting harder to find: leader

Previous print editions
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The world this week
Politics this week
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Leaders
Business and society
The search for talent

Japan and China
Talking at last

Germany's government
Angela's ashes

Gambling prohibition
Ace in a hole

American politics
The page and the book

The UN's new secretary-general
Enter Mr Ban

Letters
On Afghanistan, Thailand, the pope, Richard Dawkins, James Ellroy, Norfolk dialects

Special Report
The cold war in Asia
In dangerous waters

United States
The Republicans
Hurricane Mark batters Hastert

Congressional pages
Summoned by bells

Negative campaigning
The same to you, with knobs on

Detainees
Cold comfort

Murder in schools
The horror

Cheap drugs
Popping pills

Obesity
California eating

Lexington
Cross-eyed and clueless

The Americas
Brazil's elections
When victory spells defeat

Chile's schools
How to make them better

The United States and Latin America
A partnership constrained

Argentina and Uruguay
Arm-twisting

Asia
India and Pakistan
Bomb-blast diplomacy

Nepal
Judged by the people

Thailand
Returning to democracy

Indonesia

A survey of talent
The battle for brainpower
Everybody's doing it
The world is our oyster
Opening the doors
Nightmare scenarios
Masters of the universe
The revenge of the bell curve
Meritocracy and its discontents
Sources and acknowledgments
Offer to readers

Business
Airbus and EADS
The airliner that fell to earth

Luxury goods
One up for LVMH

The technology industry
Different strokes

Corporate scandals
The fugitive

Amazon
Lifting the bonnet

Metals and mining
The thrill of the chase

The car industry
Not playing

Face value
The cutting edge

Special Report
Online gambling
Busted flush

Finance & Economics
The euro area's economy
Feeling fitter

Buttonwood
Instant returns

Wall Street
An old dog barks

China's stockmarkets
Imperfect markets

Outsourcing mortgages
Home and away

European trade
Take your partners

Share trading
The big squeeze

Economics focus
Taped

Science & Technology
Evolution
Unity and diversity

Muddy waters

Japan
Blue-sky development

China
Football code

Correction: Poverty in Indonesia

Middle East & Africa

Iran's nuclear strategy
Making uranium while the sun shines

America and the Middle East
Friends see things differently

The Palestinian Authority
King Mahmoud

Iraq
Your man or his?

Zambia's election
The technocrat and the populist

Congo's election
Hold your breath

Europe

Germany
Angela Merkel's not-so-grand coalition

The Austrian election
Another grand coalition?

Italy's budget
Smoke and mirrors

France's presidency
Runners and riders

Georgia and Russia
The mouse that roared

The Balkans
Troubling times

Charlemagne
The stultifying Brussels consensus

Britain

School building
Who wants a new classroom?

The minimum wage
Danger zone

Prosecuting rape
Getting away with it

High-tech Tories
Tory 2.0

Natural gas
Turning down the heat

TV quizzes
Minted

Bagehot
A hard road ahead for Mr Nice Guy

Herbal medicine
African genesis

The Nobel science prizes
The little and large show

Books & Arts

General Pervez Musharraf
Military misjudgment

American foreign policy
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Lives, still and not so still

Non-violence
Nice idea

New fiction
Voyage of hope and despair

Journalism in Zimbabwe
Chronicle of a death foretold

Bertolt Brecht
A man for all seasons

Obituary

Iva Toguri

Economic and Financial Indicators

Overview

Output, demand and jobs

Prices and wages

Economic forecasts

Money and interest rates

The Economist commodity price index

Stockmarkets

Trade, exchange rates and budgets

Sovereign debt in default

Emerging-Market Indicators

Overview

Emerging-market investment

Economy

Financial markets

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Politics this week

Oct 5th 2006
From The Economist print edition

The **Republicans** had a bad week as attention focused on what the leadership in the House of Representatives knew about Mark Foley's lurid overtures to teenage pages on Capitol Hill, and when they knew it. Mr Foley resigned from his safe seat in central Florida after sexually suggestive e-mails he sent to some of the young men came to light. See article

With a month to go before the mid-term elections the White House was put on the defensive over its **Iraq** policy after the publication of Bob Woodward's latest book. The veteran Washington insider depicts an administration striving to suppress downbeat assessments about the situation in the country. See article

George Bush signed a homeland security bill that provides funds to construct 700 miles of fencing along the **border with Mexico**. Congress rushed through the measure before it adjourned last week.

AP

A man entered an **Amish** schoolhouse in Pennsylvania and shot ten young girls, killing five. The gunman, who committed suicide, apparently had a background of sexual molestation but it is not thought he bore a particular grudge against the Amish. See article

The publisher of **Miami Herald Media** resigned after three journalists he had sacked for taking “unethical” government payments were reinstated. The journalists, based at the *Miami Herald*'s Spanish-language sister publication, did some work for Radio Martí, an anti-Castro, government-funded broadcaster.

Incomplete victory

AFP

Luiz Inácio Lula da Silva failed to win a majority of the votes in **Brazil's** presidential election, forcing a run-off on October 29th. His opponent will be Geraldo Alckmin, a former governor of São Paulo. See article

An airliner collided with a private jet and crashed into the Amazon rainforest killing all 155 aboard, Brazil's worst **aviation disaster**. The private jet's two American pilots managed to land their plane and were ordered to stay in the country.

Playing a dangerous game

Tensions rose between **North Korea** and its neighbours as it announced its intention to carry out a nuclear test. Japan and South Korea gave warning of serious consequences if a test proceeded. America said it was “not going to accept” a nuclear North Korea. China urged the reclusive state to “exercise necessary calm and restraint”. See article

India said it would provide evidence to **Pakistan** that its intelligence services were involved in July's bombings in Mumbai. Pakistan described the allegation as “baseless”. See article

NATO assumed full command of peacekeeping in **Afghanistan**, taking charge of 10,000 American troops in the east of the country. The alliance now has 33,000 troops in Afghanistan; some 8,000 American soldiers are also there to hunt terrorists.

Thailand's military junta appointed a former army chief as the country's interim prime minister. General Surayud Chulanont, who is close to the king, promised a return to democracy. Meanwhile, Thaksin Shinawatra, the ousted prime minister, now in exile, resigned as the leader of the Thai Rak Thai party, the dominant force in Thai politics before the recent coup. See article

South Korea's foreign minister seemed certain to become the next **United Nations secretary-general** after winning an informal poll in the Security Council. Ban Ki-moon is expected to receive a formal endorsement next week. See article

Neighbours fall out

A row between **Georgia and Russia** got worse. The Georgians sent four alleged Russian spies back to Moscow and the Russians cut all air, road and sea links. The countries' two presidents, Russia's Vladimir Putin and Georgia's Mikhail Saakashvili, traded public insults. See article

Three people are to run for the **French Socialist Party's** presidential nomination. The favourite is Ségolène Royal; the other two candidates are Laurent Fabius, a former prime minister, and Dominique Strauss-Kahn, a former finance minister. See article

The minority centre-right **Czech government** under Mirek Topolanek lost a vote of confidence. The Czechs have not had a secure government since the election in June produced a dead heat; another election now looks likely.

Hungary's president put pressure on the prime minister, Ferenc Gyurcsany, to step down after his Socialists did badly in local elections. Mr Gyurcsany has been under pressure ever since he admitted repeatedly lying to voters, but he still refuses to go.

The prime minister of **Montenegro**, Milo Djukanovic, who led the country to independence this summer, is resigning for personal reasons.

Bosnia's election returned a clutch of leaders who may break the country apart. The prospect has also receded of more reforms necessary to start accession talks with the European Union. See article

Faction fighting

The inability of the besieged Hamas-run Palestinian Authority to pay civil servants or the security forces resulted in violent clashes between **Hamas** and **Fatah** militia in Gaza and the West Bank. Some 12 people were killed. See article

On a visit to the Middle East **Condoleezza Rice**, America's secretary of state, exchanged opinions with “moderate” Arab leaders and urged Israel to temper its blockade of the Palestinian territories. See article

In a bid to reduce sectarian killing in Baghdad, **Iraq's** prime minister announced that local security committees would be set up to supervise the security forces. Dozens of murdered bodies are discovered in the city each day. See article

Levy Mwanawasa was comfortably re-elected as **Zambia's** president, with international observers saying the poll was reasonably honest and open. Supporters of the opposition leader protested violently in Lusaka, claiming the results were rigged. See article

The remains of **Pierre de Brazza**, a French explorer who died in 1905, were exhumed in Algeria and placed in a mausoleum in Brazzaville, Congo's capital city.

AFP

Tensions increased in the **Democratic Republic of Congo** ahead of a presidential run-off election. An unmanned surveillance drone used by UN peacekeepers crashed in Kinshasa, the capital, killing a woman and sparking protests. See article

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Business this week

Oct 5th 2006
From The Economist print edition

The share prices of **online gambling** companies collapsed after America's Congress passed legislation that stops banks and credit-card issuers from making payments to them, essentially banning punters in the United States from their websites. See article

Harrah's Entertainment, the operator of Caesar's Palace and other top casinos, revealed it had received a buy-out offer of around $15 billion from two private-equity firms. Although active in a range of industries, private-equity firms have until now largely stayed clear of gambling.

After failing to reach agreement on how to share the benefits of a potential deal, **General Motors** decided not to pursue an alliance with **Renault** and **Nissan** and ended negotiations on the matter. GM will now concentrate on its own restructuring plan as it seeks a return to profitability. The alliance's non-starter is a blow to Kirk Kerkorian, a big GM investor who suggested the tie-up. Last week Mr Kerkorian gave notice of his intention to raise his stake in the carmaker. See article

More missed departures

EADS confirmed a further delay to the Airbus **A380**. It now expects to make the first delivery of the super-jumbo in October 2007, putting the project some two years behind its original schedule. The European aerospace company also upped the total amount of a projected profit shortfall over four years to *euro*4.8 billion ($6.1 billion) because of the delays. Airlines that have contracts for the A380 indicated they were considering their options. See article

Ryanair, Europe's biggest low-cost airline, launched a takeover bid for **Aer Lingus** by buying a 16% stake in its fellow Irish carrier, which made its stockmarket debut this week after converting itself into a low-cost airline.

The first criminal charges were filed in relation to **Hewlett-Packard's** boardroom spying scandal. California indicted HP's former chairman, Patricia Dunn, and former ethics lawyer as well as three outside investigators, who allegedly assisted the company to uncover a press leak. The five defendants face several charges, including identity theft.

Apple Computer completed its internal investigation into the way it has granted past stock-options and found 15 cases of improperly backdated grants. The report raised “serious concerns” about the actions of two former (unnamed) executives, but found no misconduct by the current management team, although Steve Jobs, Apple's chief executive, had been aware of the practices “in a few instances”. He apologised.

The row between **ImClone Systems** and **Carl Icahn** came to the boil when the biomedical company accused the investor of sabotaging a proposed takeover offer it had received by withholding his support. Mr Icahn, who owns 14% of ImClone, is unhappy with the company's performance and is seeking to oust six members of the board.

Cash flow

A further shake-up of Britain's water companies seemed likely after a bidding war broke out for AWG, which owns **Anglian Water**. AWG had accepted a £2.2 billion ($4.1 billion) offer from an investment group before confirming it had received rival bids from (unnamed) interested parties. With **South East Water** agreeing to be bought in a separate offer by an Australian fund manager for £665m, speculation returned to the potential of a bid for Thames Water, Britain's biggest water company.

Siemens said it would create a *euro*35m ($45m) fund to help employees at its former mobile-phone unit find new work. Last year the German engineering company sold the loss-making business to Taiwan's BenQ, which says the losses are “unsustainable” and announced it would stop funding **BenQ Mobile**. Executives at Siemens are contributing to the workers' fund by forgoing a (controversial) 30% salary increase.

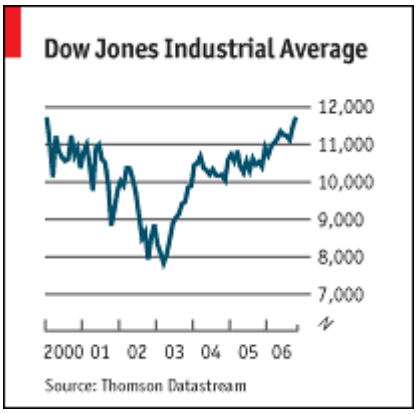
Having fallen by 23% since early August to a seven-month low of less than $60 a barrel, oil prices rose on news that ministers from the Organisation of Petroleum Exporting Countries were discussing whether to cut **oil production** by 1m barrels per day. Any cut would be the first since 2004 and could come after an emergency meeting of the cartel.

Sony's share price fell after Toshiba and Fujitsu said they, too, were recalling **Sony batteries** in some laptop computers because of fears they could overheat. Lenovo, which makes computers under the IBM brand, has also announced a recall after one of its laptops caught fire at Los Angeles airport. Dell and Apple issued recalls in August.

Measuring up

The **Dow Jones Industrial Average** broke its record closing high, which had been previously reached in January 2000. Amid the celebrations, some questioned why the DJIA continues to be viewed as the benchmark stockmarket barometer considering it is an average of only 30 share prices that ignores the market value of a company. See article

Correction: Last week we were wrong to say that Aer Lingus was the first airline to debut on the London Stock Exchange since 2000. Several airlines have floated on the LSE since then. Apologies. This has been corrected online.



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Business and society

The search for talent

Oct 5th 2006
From The Economist print edition

The world's most valuable commodity is getting harder to find

Masterfile

THESE are heady days for most companies. Profits are up. Capital is footloose and fancy-free. Trade unions are getting weaker. India and China are adding billions of new cheap workers and consumers to the world economy. This week the Dow Jones Industrial Average hit a new high.

But talk to bosses and you discover a gnawing worry—about the supply of talent. “Talent” is one of those irritating words that has been hijacked by management gurus. It used to mean innate ability, but in modern business it has become a synonym for brainpower (both natural and trained) and especially the ability to think creatively. That may sound waffly; but look around the business world and two things stand out: the modern economy places an enormous premium on brainpower; and there is not enough to go round.

The best evidence of a “talent shortage” can be seen in high-tech firms. The likes of Yahoo! and Microsoft are battling for the world's best computer scientists. Google, founded by two brainboxes, uses billboards bearing a mathematical problem: solve it for the telephone number to call. And once you have been lured in, they fight like hell to keep you: hence the growing number of Silicon Valley lawsuits.

As our survey this week shows, such worries are common in just about every business nowadays. Companies of all sorts are taking longer to fill jobs—and say they are having to make do with sub-standard employees. Ever more money is being thrown at the problem—last year 2,300 firms adopted some form of talent-management technology—and the status and size of human-resource departments have risen accordingly. These days Goldman Sachs has a “university”, McKinsey has a “people committee” and Singapore's Ministry of Manpower has an international talent division.

Trespassers will be recruited

Some of this panic is overdone—and linked to the business cycle: there was much ado about “a war for talent” in America in the 1990s, until the dotcom bubble burst. People often talk about shortages when they should really be discussing price. Eventually, supply will rise to meet demand and the market will adjust. But, while you wait, your firm might go bust. For the evidence is that the talent shortage is likely to get worse.

Nobody really disputes the idea that the demand for talent-intensive skills is rising. The value of

“intangible” assets—everything from skilled workers to patents to know-how—has ballooned from 20% of the value of companies in the S&P 500 to 70% today. The proportion of American workers doing jobs that call for complex skills has grown three times as fast as employment in general. As other economies move in the same direction, the global demand is rising quickly.

As for supply, the picture in much of the developed world is haunted by demography. By 2025 the number of people aged 15-64 is projected to fall by 7% in Germany, 9% in Italy and 14% in Japan. Even in still growing America, the imminent retirement of the baby-boomers means that companies will lose large numbers of experienced workers in a short space of time (by one count half the top people at America's 500 leading companies will go in the next five years). Meanwhile, two things are making it much harder for companies to adjust.

The first is the collapse of loyalty. Companies happily chopped out layers of managers during the 1990s; now people are likely to repay them by moving to the highest bidder. The second is the mismatch between what schools are producing and what companies need. In most Western countries schools are churning out too few scientists and engineers—and far too many people who lack the skills to work in a modern economy (that's why there are talent shortages at the top alongside structural unemployment for the low-skilled).

What about all those billions of people in the developing world? Alas, adding willing hands to the global economy is not the same as adding trained brains. Both India and China are suffering from acute skills shortages at the more sophisticated end of their economies. Wage inflation in Bangalore is close to 20%, and job turnover is double that (“Trespassers will be recruited” reads a sign in one office). The few elite institutions, such as India's Institutes of Technology, cannot meet demand. And there are also cultural legacies to deal with: India's Licence Raj destroyed management skills, while China's Confucian tradition still emphasises “face” over innovation.

A problem for all of us

This poses different challenges for companies, governments and individuals. For companies the main task is simply to end up with more talented people than their competitors. Firms will surely have to cast their net wider, employing more part-time workers and more older workers, and spending yet more on training, even in places where workers seem cheap: the training budget at Infosys, an Indian tech giant, is now well above $100m. Human-resource managers, once second-tier figures, now often rank among the highest-paid people at American firms; they will have to justify that status.

But governments too need to act. Removing barriers is a priority: even America still rations the number of highly skilled immigrants it lets in, and Japan and many European countries do far worse. But education inevitably matters most. How can India talk about its IT economy lifting the country out of poverty when 40% of its population cannot read? As for the richer world, it is hard to say which throw more talent away—America's dire public schools or Europe's dire universities. Both suffer from too little competition and what George Bush has called “the soft bigotry of low expectations”.

And the talented would do well to intervene in this debate on the side of the disadvantaged. For one last thing is sure to flow from the hunt for talent: even greater inequality. Most societies will tolerate the idea of well-rewarded winners, as long as there is equality of opportunity and the losers also clearly gain something from the system. If those conditions are not met, populist politicians from Toledo to Tokyo will clamp down—and everyone will be poorer for it. A global meritocracy is in all our interests. Be prepared to fight for it.

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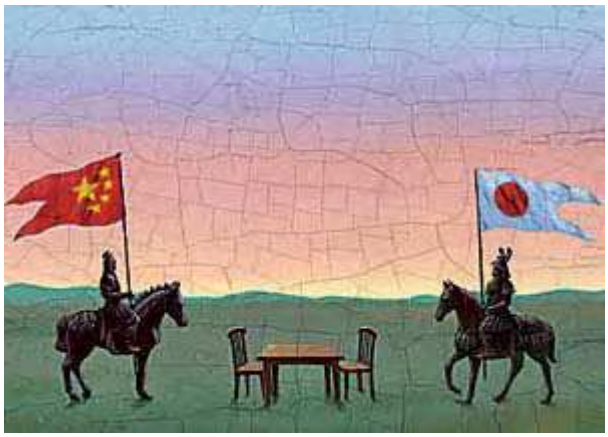
Japan and China

Talking at last

Oct 5th 2006
From The Economist print edition

A welcome thaw in East Asia's cold war would be even more useful if North Korea felt some of the heat



TRUST North Korea's Kim Jong Il to rain nuclear fallout on his neighbours' diplomatic parade. Announcing this week that he will “in the future” go ahead with a long-threatened nuclear bomb-test, Mr Kim seems bent on upstaging the first formal summit handshake in five years between the estranged leaders of Japan and China, East Asia's biggest powers and its natural and sometimes bitter rivals.

The visit by Shinzo Abe, Japan's newly installed prime minister, to China's Hu Jintao this weekend is an enormous step forward. Ill-advised annual visits by Mr Abe's predecessor, Junichiro Koizumi, to Tokyo's Yasukuni shrine, which honours Japan's war dead but also enshrines the souls of 14 “Class A” war criminals, needlessly soured diplomatic relations not just with China, but also with South Korea (which Mr Abe is visiting on Monday). It was not all Japan's fault, by any means, but the prospect of the end of its “cold war” with China (see article) offers hope of progress on all sorts of issues.

He must be stopped

Begin with the most pressing problem, the belligerent Mr Kim. Nobody has benefited more from the recent tensions. Indeed, the North Korean dictator has worked to exacerbate them to win cover for his boycott of six-way negotiations (America and Russia take part too) that aim to put an end to his nuclear plans. He was therefore incensed in July when China, his semi-friend of last resort, finally backed a toughly worded United Nations resolution, sponsored by Japan, that condemned his provocative missile tests earlier that month and called on governments around the world to help curb his missile trading. But he also knows that China is leery of tough economic sanctions, and that South Korea would like to keep trade and aid flowing to his regime at almost any cost. Since America and Japan are bound to press for sanctions in the event of a nuclear-weapon test, Mr Kim may be gambling that, rather than uniting his neighbours against him, detonating a bomb would instead blow them and America apart again.

It is in no one's interests that he be allowed to succeed. China needs regional stability to underpin its continued economic growth. A North Korean nuclear test would add to pressure for Japan, Taiwan and even governments of countries well beyond East Asia to reconsider their anti-nuclear commitments. Free to mount his nuclear bombs on his ever-farther-flying missiles, Mr Kim would be a danger to all. His promise this week not to transfer his bombs to others is likely to prove about as reliable as his earlier promises never to build them in the first place.

So China needs to tell Mr Kim, in unmistakable terms, that if the test goes ahead, biting sanctions will follow. Similarly, generous flows of South Korean aid that Mr Kim is free to divert to his armed forces or into his own pockets should stop; humanitarian assistance to North Korea's hard-pressed people should continue, but monitored by UN agencies, as other governments insist.

If China, South Korea and Japan cannot agree better on how to respond to the threat of a nuclear test, this weekend's symbolic handshakes will achieve little. That would be a pity, for there are plenty of other issues—tensions over Taiwan, over oil and gas exploration and over competing island claims—that could be better managed by being able to reach for the phone rather than sending in gunboats, as China and South Korea have sometimes done in the past.

Behind these sharpened conflicts lies something still more troubling. China and South Korea have long criticised Japan for allowing some (in reality rather few) school textbooks that gloss over its wartime atrocities. Yet theirs are no more honest about the past. The result is that young people in all three countries learn to despise each other. Mr Koizumi was wrong to visit Yasukuni, but China's leaders deliberately whipped up anti-Japanese feeling to bolster the Communist Party's nationalist credentials.

Now all sides have an opportunity for second thoughts. China has been casting about for an excuse to resume summit contacts. This is partly out of fear that anti-Japanese protests were getting out of hand, but also in an effort to protect growing trade and investment from Japan. Restoring top-level ties would also help reassure the neighbours that they have nothing to fear from China's growing economic and military clout.

For his part, Mr Abe's nationalist credentials need no burnishing (though he has not publicly ruled out future shrine visits). The new prime minister would clearly like Japan to play a more “normal” and thus prominent role in regional security: it already contributes a great deal in aid, trade, efforts to disrupt proliferation networks and the like, but is constrained from using its armed forces to help even allies in need. So Mr Abe too needs to show that the region's two most powerful countries can rub along more peaceably.

Turning to the future

Both Mr Abe and Mr Hu therefore have reason to turn the weekend's symbolic handshake into a bigger diplomatic opportunity. Yet there is still a long way to go. Unlike in Europe, where bad wartime memories have given way to binding economic, political and military alliances between former enemies, in East Asia resentments have been kept deliberately raw. Rather than overcome their past—Japan's repeated apologies have been stiff, but few of the neighbours have been ready to take sorry for an answer—all sides have relied on America to hold the ring between them.

By cold-shouldering Japan in recent years, China and South Korea have ensured that even the few feeble regional talking shops that do exist have been able to do nothing to mitigate tensions. America has no intention of leaving East Asia to its own devices—it has far too big a stake of its own in peace in the region to do that. But it is surely time for rich Japan, increasingly prosperous South Korea and a more powerful China to shoulder more of the security burden among themselves. That means ending their debilitating private cold war—and letting North Korea's Mr Kim be the first to feel the heat.

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Germany's government

Angela's ashes

Oct 5th 2006
From The Economist print edition

The German chancellor needs to be bolder in pursuing reforms

Reuters

IT WAS never going to be easy for Angela Merkel to run a “grand coalition” government. After all, the coalition, between her centre-right Christian Democrats and the centre-left Social Democrats, came about only because she and her party did unexpectedly badly in last September's election. And, although Germany is a consensus-loving country, it does not warm to left-right coalitions at the federal level: the previous one, between 1966 and 1969, was not a particularly happy affair.

Despite this, at the start of the year Ms Merkel looked surprisingly good. Her early foreign-policy forays, especially to Washington, DC, and Brussels, were glittering successes that drew a favourable contrast with her Social Democratic predecessor, Gerhard Schröder. The economy was at last picking up some momentum. Business confidence was high. Her party was even gaining ground with the electorate. For a brief moment, indeed, Ms Merkel was the most popular chancellor in history, scoring an 80% approval rating in the polls.

In the past few weeks, however, she has come down to earth with a bump. A fractious dispute over health-care reform, which was supposed to be a centrepiece of the government's domestic agenda, has brought home how hard it is for the two coalition partners to agree on anything (see article). Ms Merkel seems unable even to make deals with her own party's powerful state premiers, some of whom seem more interested in replacing her than in settling policy differences. Opinion polls and recent state elections show that support for both main parties continues to ebb. One recent poll even puts the Christian Democrats behind the Social Democrats, for the first time since Ms Merkel became chancellor.

It is true that the economy is still doing quite well, and unemployment continues to fall—although only in Germany would this year's expected GDP growth of up to 2.5% be greeted with enthusiasm. But it is also true that Germany, like much of Europe, needs more substantial reforms to regain its economic vitality. The labour market is too regulated, taxes are too complex and too high, the public sector is bloated and unresponsive, the education and health systems need a shake-up. Yet because the two main parties disagree so much, the grand coalition has barely begun to tackle any of these.

This lady shouldn't be for turning

A good way forward would be for Ms Merkel herself to show some stronger leadership. She should start by exerting more discipline within her own party, as she is belatedly threatening to do by pulling her state premiers into line. But she might also have to consider other options. One is to prepare the ground for a different coalition, without the Social Democrats. The obvious one would combine the Christian Democrats, the Free Democrats and the Greens—a grouping known from the black, yellow and green party colours as a Jamaica coalition. However, even a Jamaica coalition would find it hard to agree on reforms, not least to health care. So she should also consider a second option: to plan for an early election. It is not straightforward to call one in Germany, but it might be possible to engineer an early poll in the second half of next year, after Germany's first-half presidency of the European Union and the G8 summit are both over.

Throughout her political career, Ms Merkel has always made it clear that her instincts are to make progress in small steps, not giant leaps. She is by nature cautious, not bold. The trouble is that just now there is little sign of her taking even small steps in the direction of significant reform in Germany. If she is to have a lasting political impact on her country, she must start soon.

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Gambling prohibition

Ace in a hole

Oct 5th 2006
From The Economist print edition

Internet gambling is good for consumers. Too bad America wants to ban it

THE spread of the internet has made the online gambler king. The emergence of large online gambling companies has slashed gaming operators' margins and driven up payout ratios for gamblers. And the punters have embraced it in their millions, especially in America, where illegal gambling has long flourished. Last year 12m Americans placed about $6 billion in online bets, half the world's total.

You might have hoped politicians would greet such a demonstration of popularity with moderation—welcoming online gambling's benefits and curbing its inevitable excesses. Instead they have put all their chips on red. Last weekend Congress passed a bill that will stop banks making payments to online gambling sites, adding to an already formidable legislative arsenal that outlaws most online gaming.

Given America's tolerance of many other forms of gambling including horse racing and casinos, that looks like hypocrisy. Worse still, the new bill is self-defeating. It will leave the people determined to bet—the very group most vulnerable to gambling's excesses—more open to predation from the unscrupulous online gambling joints that lawmakers most fear.

Gambling is tailor-made for cyberspace. The internet's erasure of geography lets people have a flutter without having to leave their living-rooms for the Bellagio's bombast or the shabbiness of the local dive (see article). But it has also brought a healthy dose of transparency and competition to an industry split three ways between state-protected monopolies, commercial operators and dodgy illegal gambling dens.

State-protected lotteries and horse-races generally offer terrible odds for punters, while their sponsoring governments have imposed hefty sin taxes. Casinos and resorts have lower payouts than online gambling and you have to fork out for the hotel room, too. The parallel world of underground gaming houses pays out more and it is tax-free. Then again, it carries the risk of arrest; and operators are horribly creative when it comes to collecting their debts.

Internet gambling deals with these drawbacks and has also enjoyed a flowering of innovation, much of which has furthered consumer power. For instance, exchanges—the gambling equivalent of online auction sites—have lowered the costs of betting by cutting out bookmakers through matching gamblers offering and accepting bets on just about anything.

So why ban it? The basic answer is politics. The Republican Party's sudden concern for the welfare of vulnerable gamblers comes just before the mid-term elections. The new bill will cosset the Christian right

and the states' own monopolies, rather than protect the weak. Big American offline operators stand to benefit from the decline of rampant online rivals. Huge swathes of America's online gambling industry, chiefly horse-racing and state lotteries, are exempt from the bill.

However, even if you don't believe the cant from Congress, there is a case to be made that online gambling is worse than the real-world sort. Internet sites encourage gambling among youngsters who would normally be kept out of casinos. In legal joints regulators can bar the most addictive sorts of gambling machines. Online casinos, on the other hand, often try to make their games as compulsive as they can. And the whole business is, critics argue, overshadowed by criminality. Because the punters in online casinos may have no idea who is on the other end of the line, they are vulnerable to swindles and crooks; they may be ripped off by rigged games; they may have their credit-card details stolen; and so on.

The House wins

These, however, are arguments for regulating online gambling, not banning it. Online gambling, like all gambling, can destroy people's lives. Yet it also brings a huge amount of pleasure. And the spread of internet gaming also has the potential to make gambling safer. The new bill bans payment through credit cards, yet credit cards can help establish age and loss-limits. Regulators can ensure these limits are applied to players, not casinos, to stop problem gamblers from hopping from one site to another. Regulators can say what games are allowed, to reduce their addictiveness, and get the industry to promote counselling services for problem gamblers. They can protect consumers by having sites display payout ratios and by refusing to certify dodgy operators.

The list is a long one and, of course, such regulation will not always work. But it is better than prohibition, which, even if you wanted to stop gaming, would just drive gamblers into the arms of crooks.

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American politics

The page and the book

Oct 5th 2006
From The Economist print edition

A terrible week for conservatives in Washington, DC

Reuters

THESE are miserable times for American conservatives. The free-spending ways of Republicans in both the White House and Congress have long been a sore point with the party's deficit-hating voter base. The fiasco in Iraq has thrown away what ought to be a natural advantage for the right, keeping America safe from its enemies. But at least the Republican Party was dependable where it counts most of all to conservatives: the protection of family values. Until now.

On September 29th Mark Foley, a Republican congressman from Florida, resigned his seat following the disclosure that he had sent indecent e-mails and instant-messages to at least two teenage male congressional pages. In one exchange Mr Foley (pictured above) appears to be soliciting internet sex with a boy whom he refers to as “my favourite young stud”. Incredibly, Mr Foley was the head of a committee on missing and exploited children at the time.

If this sordid tale were the whole of it, Mr Foley's disappearance into rehab for the treatment of “alcoholism and related behavioural problems” might mark the limit of the Republicans' problems. But inevitably a bigger row has exploded over a supposed cover-up. Senior Republican leaders, from the speaker of the House of Representatives, Dennis Hastert, downwards, are being accused of turning a blind eye to Mr Foley's predilection for pages. Complaints about him may date back as far as 2001, though it seems clear that the grosser evidence emerged only last week. But, at the very least, Mr Hastert is guilty of failing to investigate a serious matter with any great diligence. It took ABC News only 24 hours after receiving some of the more innocuous e-mails, which the Republican leadership has known about for a year (possibly much longer), to get its hands on the hardcore stuff.

The immoral majority?

Mr Hastert has already faced calls for his resignation, from the right more than from the left. He may yet tough it out, but the row has the potential to infuriate not just conservatives, but moderates too. They will be appalled at the hypocrisy of a party that persecutes homosexuals (not to mention Bill Clinton) in the name of family values while covering up for a homosexual sex-pest of its own.

It is hard to quantify the overall effect of the latest scandal on November's mid-term elections, in which the Democrats have a good chance of taking back the House. But, at the least, Mr Foley's resignation has

turned his own seat in Florida from safe to extremely dodgy (his name will remain on the ballot there), just as corruption charges against two other Republicans, Robert Ney in Ohio and Tom DeLay in Texas, have opened up two other safe seats. With the Democrats needing to turn just 15 seats to win the House, the Republicans cannot afford any more Foleys.

Nor can they afford too many more books like Robert Woodward's “State of Denial”, published on October 2nd and already re-printing. Mr Woodward does exactly what the Republicans least need: he focuses attention not just on the astonishing mismanagement of the war in Iraq, but also on the earlier failure to see al-Qaeda coming (see article).

All the president's blunders

To an extent, the war is now a given. The Democrats have no good answers as to how they might fight it better, and few of them can claim that they would not have fought it in the first place. They cannot even agree on whether America should stick it out, or start to bring its troops home. Security at home, however, is different. George Bush has done a good job in recent weeks of conveying the impression that he is better at protecting America from external threats than the Democrats would be. His insistence on needing the power to torture suspects and hold them without trial is a (grotesque) plus point in this regard. The conservative right has appropriated security as its own issue, part of its “culture of life”, yoking together opposition to abortion as well as terrorism, as opposed to the Islamists' “culture of death”.

But Mr Woodward has levelled a deeply embarrassing charge against Condoleezza Rice, then national security adviser and now secretary of state: that she was given detailed warning of an imminent attack, and did nothing about it. Ms Rice denies this. At worst, she could face some awkward legal questions; at best, the Republicans' grip on security, like their grip on family values, looks a lot less firm than it did just a week ago.

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The UN's new secretary-general

Enter Mr Ban

Oct 5th 2006
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Might a grey man from Korea be exactly the right choice to succeed Kofi Annan?

Getty Images

IT IS not yet official but now it is all but certain. Ban Ki-moon, South Korea's long-serving foreign minister, will become the United Nations' new secretary-general when Kofi Annan quits at the end of the year. The choice does not set the pulse racing. In Korea Mr Ban's nickname is Ban-*chusa*—a loose translation of *chusa* being “administrative clerk”. This double-edged moniker, used by friends and foes alike, hints not only at Mr Ban's fastidiousness, attention to detail and highly regarded administrative skills but also at a lack of charisma and a supposed willingness to bend to the will of his superiors. Many will say that the UN's opaque selection procedure has alighted upon the lowest common denominator: a yes-man who will shrink from standing up to the big powers and driving overdue reforms through the world body.

It would, however, be wrong to write off Mr Ban prematurely. For one thing, the UN could sorely use a spot of fastidious administration just now. Mr Annan was not the venal incompetent that some of his critics in America tried to paint him as. But he has certainly been a weak manager. An investigation a year ago by Paul Volcker into the UN's mishandling of the Iraqi oil-for-food arrangement in the 1990s concluded that the programme was riddled with waste and corruption, and that this reflected the absence of “a strong organisational ethic”. As the UN's chief administrative officer, the man with ultimate responsibility was the secretary-general. Mr Annan was lucky to hold on to his job. If Mr Ban moves swiftly to overhaul the UN's administration, bring in new talent and restore bureaucratic morale, doubts about the faceless *chusa* from Korea could swiftly subside.

But shouldn't the secretary-general of the UN be much more than just an able bureaucrat? Up to a point. Dag Hammarskjöld showed in the 1950s that the right man in the right circumstances could indeed use the job to become a powerful international statesman, troubleshooter and problem-solver. Arguably, the need for that sort of secretary-general has lately become more pressing. After the divisions in the Security Council over the Iraq war, and given the divisions that may now open up over intervention in Darfur and Iran's nuclear programme, there exists a great appetite the world over for a UN that lives up to the aspirations of its founding charter as a rule-setting body and arbiter in international relations. Such a body needs to stand proudly independent of both the superpower and any collection of individual

states. And that would in turn seem to demand a top diplomat with supreme confidence and moral authority, not a little-known official who boasts of having spent his 35-odd years of public service being “basically a harmoniser”.

Charisma and its limitations

And yet it is a harmoniser, not a tub-thumper, the UN most needs. Many people think of the UN as a sort of world government, laying down international law with the same authority as a national government lays down domestic law. It is of course nothing of the sort, since it lacks both the legitimacy of an elected government and—except when its members choose to provide it—any means of enforcement. A secretary-general who thought otherwise would bump at once into the realities of power. Remember that even the admired Hammarskjöld made a quiet start, proving his worth as a mediator behind the scenes before earning the trust of the big powers.

Nothing in his past suggests that Mr Ban will turn out as well as that. The job may just be too big for him. But he starts with some advantages, one of which is that he owes his selection in part to the support of both the United States and China. If he is the yes-man his critics say he is, he will soon discover the impossibility of saying yes both to the established superpower and to its emerging rival. But if he is the bridge-builder he claims to be, and can combine building bridges with sound management, he stands a better chance than his predecessor of promoting reform. He deserves to be given a chance.

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On Afghanistan, Thailand, the pope, Richard Dawkins, James Ellroy, Norfolk dialects

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From The Economist print edition

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De facto Afghanistan

SIR – You highlighted how the Taliban insurgency in Afghanistan was "underestimated" ("No more missions, please", September 23rd) and have called for "a more flexible Western policy, and some humility" in dealing with the situation ("In meltdown", September 9th). Sadly, the need for humility in Afghanistan is nothing new: it underpinned errors made during the Anglo-Afghan war 168 years ago.

The Simla Manifesto of October 1st 1838 declared war, in effect, on Afghanistan and was full of overconfident assumptions, such as: "Throughout the approaching operations, the British influence will be sedulously employed to further every measure of general benefit, to reconcile differences, to secure oblivion of injuries, and put an end to the distractions, by which, for many years, the welfare and the happiness of the Afghans have been impaired."

However, just four months later the benefit of taking a more humble approach was already apparent. Colonel Claude Wade, the governor-general's political agent, warned Lord Auckland, his boss, about: "the overweening confidence with which Europeans are too often accustomed to regard the excellence of their own institutions and the anxiety that they display to introduce them in new and untried soils...we are liable to meet with more opposition in the attempt to disturb what we find existing than from the exercise of our physical force." His words carry the same resonance today.

Ian Gordon
President
IDG Security (Afghanistan)
Kabul

Thailand's future

SIR – We in Thailand value all of the views and opinions that have been expressed in the international media about our current political situation ("Thailand's dangerous coup", September 23rd). Thais, as a whole, remain optimistic about the country's future—the interim constitution sets a timeframe for the establishment of a civilian government in the national assembly as well as the procedures for drafting a "new" constitution. This will provide for a free and fair general election that makes sure true democratic principles are achieved.

Thailand has also given assurances that it will adhere to its commitments under the UN charter and to its other international treaty obligations. It has retained the institutional mechanisms that enable a democratic system to function, including the national commissions on elections, counter-corruption, and human rights. However, keeping the trust of the international community will also be vital in helping Thailand to return to the democratic fold.

Kitti Wasinondh
Director-general
Department of information
Ministry of Foreign Affairs
Bangkok

Vatican counsel

SIR – In his poorly timed lecture the pope did not seem to argue just that “religion and reason go together” (“When the heavens open”, September 23rd). Rather, he seemed to be saying that one religion in particular (guess which one) sits well with reason, while others, such as Islam, do not. This argument is untenable because, among other things, Muslims were the first to learn from and build on Greek philosophy before passing the learning on to Europe during the Middle Ages.

Rational notions of God and religion also exist within Islam. The pope's reading of history reflects a flavour of arrogance and Western bias, as if Christians never employed the sword in spreading the word. This helps explain why his speech incensed even ordinary, non-fanatical Muslims. Europeans who believe that Europe's political and economic accomplishments stem more from the Reformation and Enlightenment than in the teachings of the Catholic church should have vented similar outrage.

Murat Somer
Assistant professor of international relations
Koc University
Istanbul

God and man

SIR – Given Richard Dawkins's status as an evolutionary biologist, I am sure his all-out assault on religion will be read with due reverence (“Misbegotten sons”, September 23rd). But there is a fundamental difference between religion and religiosity. Some evolutionary psychologists believe that the latter is rooted in the universal fear of animals and an associated attempt to appease the beasts through emulation. Hence the parallel emergence of shamanism throughout the prehistoric world. Maybe religion has no biological basis, but religiosity surely does and it must have been to our evolutionary advantage. Of course, this has not been the case for ages and it is time we jettisoned our prehistoric baggage.

Ranko Bon
Motovun, Croatia

SIR – Your laudatory review of “The God Delusion” seems to accept the tenet that “it was religious faith that ultimately turned [the September 11th terrorists] into killing machines” and that “religious moderates make the world safe for fundamentalists.” However, the historical fact remains that the most murderous sets of beliefs ever adopted were those two great, modern and officially atheist ideologies, communism and National Socialism. So much for scientific hubris.

Marqués de Tamarón
Madrid

Murdering literature

SIR – I consider James Ellroy's literature and journalism to be national treasures, but film adaptations of his work have been failures (“Deconstructing the Dahlia”, September 16th). People who avoid his books because they have already seen the films have no idea what they are missing. The surreal plot, complexity, poetry and pervasive humour of the written “LA Confidential” are totally absent from the film. It is even better when read aloud in a rapid, Walter Winchell fashion as can be found on some audio-book versions. As your review of “The Black Dahlia” suggests, this film fares barely better. Stick to the written word.

Fred Crowe
Bend, Oregon

Come again?

SIR – It seems that even linguistic experts have difficulty in grappling with East Anglian grammar (“Dew you go down to Norfolk?”, September 2nd). The sentence, “You had better go to bed dew you be tired in the morning”, should have read, “You had better go to bed dornt yew'll be tired in the morning.” “Dew” would have been correct had the speaker said “Don't stay up late dew yew'll be tired in the morning”. Thus used, the words “dew” and “dornt” can be construed as shorthand for “If you do” and “If you don't”.

Maurice Sewell Woods
Beccles, Suffolk

SIR – “Dew you go down to Norfolk?” does not need a question-mark as it is an instruction. When Admiral Nelson lay dying he told Captain Hardy to, “Do you anchor Hardy”, which was an order. This is not just being pedantic, but simply to make sure people understand the nuances of the Norfolk native's way of speaking.

Peter Brooks
Acting secretary, FOND (Friends of Norfolk Dialect)
Sheringham, Norfolk

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The cold war in Asia

In dangerous waters

Oct 5th 2006 | BEIJING AND TOKYO
From The Economist print edition

As North Korea unsettles the region again, the prospects for better relations between Japan and China are still bedevilled by history

Reuters

LAST July North Korea fired ballistic missiles into the Sea of Japan. On October 3rd it announced that it would test a nuclear bomb. Relations between the big powers of north Asia are notoriously bad. But this week also brought a ray of light: Shinzo Abe, Japan's new prime minister, declared that his first priority would be to travel to Beijing on October 8th to meet President Hu Jintao and Prime Minister Wen Jiabao, the first formal summit between the two countries in five years. The next day, Mr Abe will attempt the same with South Korea, stopping off in Seoul to meet President Roh Moo-hyun.

North Korea's defiance makes these delicate missions both more difficult and more necessary. Balances of power and influence in north Asia are shifting in unpredictable ways. Japanese economic supremacy not long ago went unquestioned, backed as it was by Japan's defence alliance with America. Now China's rise, economic and military, poses challenges to both. Japan's economic interdependence with China in deepening, but the two countries are also lining up as strategic rivals. This, as much as anything, fuels the desire in Japan to change the country's pacifist constitution, imposed on it by the Americans after the second world war, in a way that would give Japan a less constrained military force.

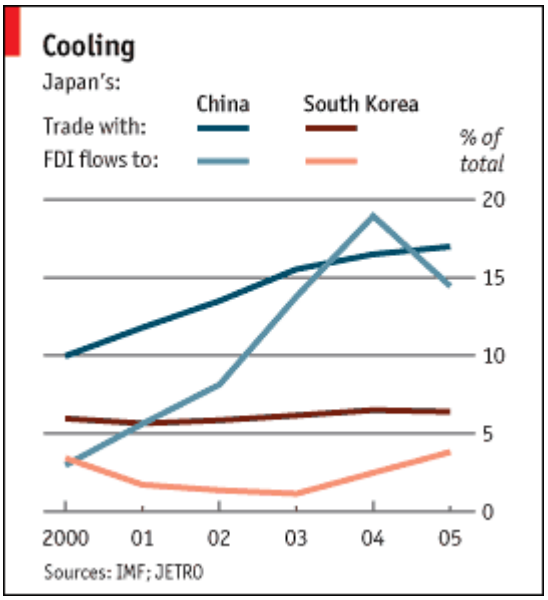
The increasing sophistication of South Korea's economy, and its growing links with China, also have consequences for Japan. South Korea, though a military ally of America's, is moving into—or returning to—China's sphere of influence. Japan's territorial disputes with both China and South Korea over the Spratlys are inflamed by the possibility of rich resources around these wretched specks of rock.

Into this mix, dangerously and unpredictably, comes North Korea. Japan legitimately sees itself as a possible target of North Korean aggression. But though China and South Korea also abhor North Korea's provocations, they are alarmed almost as much by Japan's hawkish response. This summer, before he was prime minister, Mr Abe wondered aloud about launching pre-emptive strikes against North Korea, though Japan lacks the capability to do that yet. In north-east Asia the cold war simmers on.

Japan's troubles with its neighbours are still vexed by past belligerence. In particular, they remember Japan's aggression between 1894, when it first went to war with China, and 1945, its total defeat after the second world war. The leader-to-leader summits that Mr Abe is attempting to revive, after all, were broken off by China and South Korea because of the annual visits that his predecessor, Junichiro

Koizumi, made to Tokyo's Yasukuni shrine.

This Shinto shrine is a quiet compound, white with cherry blossom in spring, that sits in the heart of the capital's bustle. It was founded, rather like Arlington Cemetery outside Washington, DC, to commemorate those who died in the mid-19th century civil wars that unified the country. Since then, the souls of 2.5m Japanese war dead have been enshrined there. Unlike Arlington, however, 14 top war criminals from the second world war (including Hideki Tojo, the executed wartime leader) were also enshrined in 1978, after Yasukuni's direct links with the state had been severed. An adjacent museum paints Japan's wars between 1931 and 1945, first in China and then across Asia, as the actions of a peace-loving nation liberating the region from Western imperialists.



In fact about 20m Asians died in these wars. In China alone, perhaps 10m died in scorched-earth campaigns, massacres of civilians and biological warfare—all glossed over by revisionists, and still taught at some schools as merely “The China Incident”. Though most of the 8m visitors a year honour family and friends who died, Yasukuni has a deserved reputation in Asia as the site of an extreme and hardline view of Japan's past and future.

Mr Koizumi's Yasukuni visits caused protests across China. Yet he is no warmonger. His visits, according to Ian Buruma, the author of several books on Asia, played to a new mood of patriotic populism in a country that sees both China and South Korea as new economic rivals, and that objects to being lectured about ancient guilt by the undemocratic Chinese.

A sharp taste of the new mood can be found in a private bookshop in Kasumigaseki, in downtown Tokyo. The tiny shop is crammed with bestsellers, some of them thick *manga* comic books. One of the most popular *manga* authors is Yoshinori Kobayashi, whose first volume of his series “On War” sold nearly 1m copies. In it, he claimed that Japan's Asian wars were honourable and that Japanese atrocities such as the 1937 Nanjing massacre never happened. His latest book describes how Japan's Class A war criminals were actually victims.

Yasukuni has a deserved reputation in Asia as the site of an extreme and hardline view of Japan's past and future

Titles by other authors explain why South Korea is “the nuisance neighbour” with an inferiority complex towards Japan, and why the Chinese are hated around the world: they are self-centred, have boorish manners (spitting, never queuing) and spread disease. In the *manga* books, the Japanese are usually drawn with blond hair and Caucasian features—a habit that reflects a long-held desire in Japan to identify with the West rather than with Asia. Koreans and Chinese, on the other hand, are depicted as swarthy, brutish and slit-eyed.

Yoshiko Nozaki of the State University of New York at Buffalo argues in *Japan Focus*, an online journal, that the ability of neonationalists to make historical certainties such as the Nanjing massacre sound controversial leads the public to feel that these issues remain unresolved among experts. Certainly, such books are so ubiquitous in Japan that the visitor soon ceases to be shocked. What surprises still is that this particular little bookstore sits on the first floor of Japan's foreign ministry.

The view from China

When Mr Abe arrives at Beijing's Capital Airport on October 8th, few Chinese will be aware that $250m in cheap loans from Japan helped pay for a big expansion of the facility in the 1990s. In China's state-controlled media, Japan is rarely portrayed positively. There is hardly a mention of the tens of billions of dollars-worth of low-interest loans and outright gifts that Japan has given China since the late 1970s—loans that China has thought of as its due as a developing country, and which it does not care to see as atonement for the war. When Japan decided last year to phase out its loan aid to China by 2008, the state media published indignant commentaries describing this as an affront, and only in passing revealed details of Japan's largesse.

For the Chinese Communist Party, it is useful to portray Japan as an unrepentant aggressor with dreams of reasserting military dominance over Asia. The party has always sought to assert its legitimacy by representing itself as a bulwark against Japanese hegemony. China's school textbooks are filled with stories of communist heroism in the war, and of Japanese brutality. Since the crushing of the Tiananmen Square protests in 1989 and the collapse of much of the rest of the communist world in the early 1990s, the party has struggled all the harder to justify its grip on power. “Patriotic education”, stressing the party's wartime role and the depravities of the Japanese invaders, has played a central role in this effort.

Reuters

Yasukuni, both shrine and provocation

But Chinese leaders know the dangers of giving nationalism too free a rein. Police stood by as thousands of demonstrators protested outside Japanese diplomatic missions in China in April last year. This, the biggest upsurge of anti-Japanese unrest in years, was sparked by a visit by Mr Koizumi to Yasukuni. But the authorities quickly grew nervous and sent clear signals that the protests must stop. Their worry is that nationalist unrest may turn against the government and undermine China's efforts to convince the rest of the world that its economic rise is unthreatening. Anti-Japanese organisations are closely monitored by the police.

The government also worries about the possible impact on Japanese direct investment, which last year overtook that of South Korea to reach $6.5 billion, more than one-tenth of the total received by China in 2005 according to China's figures. Businesses in China with a share of Japanese investment employ some 9.2m Chinese. Yet Japanese investment rose by nearly 20% last year despite the demonstrations, suggesting continuing confidence among Japanese businessmen in the security of their assets in China. Japanese exports to China increased by a more lacklustre 6.4% compared with the previous year's 27.2%. But public disdain for Japanese products appears to have played little part in this. Growth was strongest in the second half of the year, after the protests.

Consumers certainly make harsh judgments about Japanese products. Since mid-September the Chinese media have railed against SK-II, a Japanese cosmetics brand owned by Procter & Gamble, an American household-goods company, because of traces of heavy metals found in its skincare products. (Procter & Gamble says the cosmetics concerned are safe, meeting standards in Japan.) State-run newspapers have highlighted the Japanese rather than American connections of the products. In Shanghai, angry consumers besieged SK-II counters until police dispersed them. Most Chinese profess contempt for “little Japan”, and young people with no experience of the war often jeer more stridently than their parents. But few appear to let patriotism get in the way of shopping.

The government's fears of nationalism turning against the party itself may be better founded. The protests last year mainly involved members of the new middle classes whom the party regards as a bulwark of its support, and whose nationalist expectations have to be met. The demonstrations were organised using the internet and mobile phones, apparently spontaneously: a tactic that shocked the authorities, and may well have encouraged their efforts in recent months to clamp down on online dissent.

The limits of China's nationalism are suggested by the government's decision to arrange Mr Abe's trip without a public pledge beforehand not to visit the Yasukuni shrine. It is also unlikely to insist that Japan make concessions on the evaluation of its wartime history as a precondition for resuming normal top-level contacts. The Chinese leadership does not want to make specific demands that will be rebuffed by

Japan and thus provide an excuse for a fresh round of protests.

A problem called North Korea

Nor is it likely that China will allow its frosty relationship with Japan to affect its handling of North Korea. In July, China departed from its normal reluctance to censure North Korea by supporting a United Nations Security Council resolution, drafted by Japan, condemning North Korea's missile tests earlier that month. The resolution forbade trade in missile technology with North Korea and called for a halt to missile testing. To encourage China not to veto the resolution, a clause was removed that could have been construed as approving military action against North Korea in the event of its non-compliance. But the Americans and Japanese were delighted that China was willing to make its disapproval so public.

Continuing friction between China and Japan could have serious consequences, however, if North Korea decides to conduct a nuclear test. China would then be worried that Japan would respond by developing its own nuclear capability, or by launching pre-emptive strikes against North Korean missile bases. Its hope is that Japan's reaction would be restrained by America, which does not want a nuclear arms race in the region any more than China does. But it is not confident of America's ability to do this.

China's chief foreign-policy objective in the near term is to avoid confrontation in order to give itself breathing room to focus on the economy and manage wrenching social change. It does not want problems with Japan to escalate. Although little progress has been made in the two countries' discussions about gas extraction in the East China Sea, China has not aggressively pushed its claims to an exclusive economic zone stretching close to Okinawa. It hopes that re-establishing top-level dialogue with Japan will help avoid a crisis if, for example, military vessels should happen to collide in the area.

But China's stand-off with America over Taiwan will still overshadow its relationship with Japan. China will continue to brush aside Japan's longstanding complaints about the secretiveness of China's armed forces and the big annual increases in its budget. America has the same complaints, to which China has responded with only a few token gestures. China will continue gearing up its navy for possible conflict in the Taiwan Strait, an area of enormous strategic concern to Japan because it straddles vital shipping lanes.

China's stand-off with America over Taiwan will still overshadow its relationship with Japan

These preparations, which have intensified since the late 1990s, include the deployment of medium-range missiles capable of hitting Japanese targets—a strategy aimed at deterring Japanese assistance for any American intervention in such a conflict. But China does not appear to have any plans to attack, except in the extremely unlikely event that the island changes its constitution to sever its notional links with the mainland. In the past couple of years, in fact, China has become less belligerent and increasingly confident that a more malleable government, more eager to establish good relations with the mainland, will take power on the island in the next presidential elections in 2008.

China is unlikely either to order any sweeping changes to the anti-Japanese stance of its history textbooks. In Shanghai there has at least been a glimmer of flexibility in the recent publication of a school textbook that reportedly devotes less space than usual to foreign invasions (including Japanese wartime atrocities) and more to the history of positive trends such as technological innovation. But a torrent of online criticism of the book is likely to make the government cautious about spreading its use more widely. When it comes to dealing with anything Japan-related, public opinion counts in China.

President Hu Jintao is now trying to consolidate his grip on power in the buildup to a crucial five-yearly party congress late next year, at which he hopes to install protégés who will eventually take over from him. As a cautious man, he is unlikely to risk making big adjustments in the months ahead to such a sensitive area of foreign policy as relations with Japan. But if Mr Abe at least stays away from the Yasukuni shrine, Mr Hu will feel that his ostracism of Mr Koizumi has paid off.

History lessons

On his trip to China and South Korea, can Mr Abe give indications of greater sincerity than Mr Koizumi? On foreign policy, the prime minister employs cooler calculations than his predecessor, who seemed too often to operate on an emotional plane. Mr Abe also has impeccable conservative credentials, which inoculate him against charges at home of being soft on China. With his call for more “forward-looking”

relations, it is possible that his summitry will be deemed a success by all sides. On the other hand, in the long run both Mr Abe's gut beliefs and his strong sense of being the heir to a political dynasty argue against the kind of frank assessment of Japan's past that the neighbours are calling for.

Mr Abe's grandfather was Nobusuke Kishi. As prime minister in 1960 Kishi strengthened Japan's alliance with America, arguing that it was in Japan's national interest to do so. His grandson now forcefully argues that the alliance can be further strengthened only if Japan plays a greater part in its own defence; hence his support for constitutional change. But Mr Abe's beloved grandfather was also a key official in Japan's war efforts. During the 1930s he ran industrial policy in the puppet-state of Manchuria. In the 1940s, as minister for munitions, he oversaw the forced-labour programmes. After the war he was indicted as a Class A war criminal, though never charged.

Mr Abe, a regular Yasukuni-goer before he became prime minister, has sought to protect his grandfather's name. He does not believe Japan's wartime behaviour to be exceptionally evil. He has questioned the legitimacy of the victors' Tokyo tribunal that judged war criminals, though he will presumably peddle a softer line now that he is prime minister. Yet even if Mr Abe does not visit Yasukuni as prime minister, says Yukio Hatoyama, secretary-general of the opposition Democratic Party of Japan, uncertainty about whether he will go or not will still harm Japan's relations with China and South Korea.

Above all, Mr Abe has hammered home to his people the need for Japan to stand tall. He insists that Japan's young need a patriotic education that leaves out the uncomfortable bits of the past. This may imbue Japan's shiftless youth with manliness, but it is unlikely to ease Japan's relations with its neighbours. There is no getting away from history.

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The Republicans

Hurricane Mark batters Hastert

Oct 5th 2006 | PALM BEACH GARDENS
From The Economist print edition

Getty Images

A sex scandal flummoxes Republicans in Washington, DC, and Florida

TIM MAHONEY must be the luckiest man in politics. Last week he was trailing his Republican opponent, Mark Foley, an incumbent Florida congressman, by 13 points (according to his own poll), and getting pounded by brutal attack ads. Now Mr Foley (pictured on the left) has exploded in a lurid scandal. On September 28th ABC News ran a report on suggestive e-mails that he had sent to a 16-year-old former congressional page. More explicit instant messages to another page surfaced the following day, and Mr Foley promptly resigned. “I was shocked,” says Mr Mahoney, reflecting the views of most Floridians. He now stands an excellent chance of winning the seat.

But the Republicans are now bracing for much more serious fallout from Mr Foley's disgrace. Washington is convulsed with who-knew-what-when questions. Some Republicans have called for the resignation of Dennis Hastert, the speaker of the House (on the right above). His staff apparently knew of the e-mails Mr Foley sent to one of the pages, asking for a “pic” and what he wanted for his birthday. But Mr Foley got away with a light caution, as the messages were dismissed (in Mr Hastert's words) as “over friendly”. Extraordinarily, Mr Foley stayed in his post as co-chairman of the House caucus on missing and exploited children. Mr Hastert insists that he did not know of other, more explicit messages to pages. Some asked for a “kiss” or proposed “a few drinks”. One series, published on the internet by ABC, is hardcore and is being scrutinised by the FBI to determine whether a crime was committed.

Democrats are pressing for an independent investigation of why the Republican leadership failed to latch on to Mr Foley sooner. “They dealt with it politically,” said Nancy Pelosi, the Democratic minority leader, in Florida this week to talk to old folk about Medicare. “They were protecting Mark Foley instead of protecting the children.” The House ethics committee is investigating the Foley matter, but so far George Bush has backed Mr Hastert. Meanwhile, Mr Foley has confessed to being a long-time alcoholic and claims to have been abused by a clergyman during childhood. If criminal charges are brought against him, the Republicans' woes will deepen. The claim, made on October 4th by Mr Foley's former chief of staff, that he had alerted the leadership to his fears about his boss's behaviour at least three years ago, was another blow.

Mr Foley's demise also hurts his party in the pivotal state of Florida. Bad enough was the candidacy of Katherine Harris, who is making a conservative bid for the Senate. Before she won the primary Republicans thought they had a chance of ousting Bill Nelson, the one-term incumbent. Ms Harris gained

the eternal ire of Democrats during the 2000 election when, as Florida's secretary of state, she rejected efforts to hand-count controversial and crucial Palm Beach County ballots. Mr Nelson's lead stands at 27 points in the latest poll, and he is far ahead in cash reserves. Ms Harris has occasionally spiralled into absurd proclamations. “If you're not electing Christians, then in essence you are going to legislate sin,” she told one Baptist audience.

Still, all is hardly lost for state Republicans. Jeb Bush, the popular Republican governor who has dominated state politics since being elected in 1998, cannot stand again. But Republicans look likely to hold the post. Charlie Crist, the state attorney-general, holds a double-digit lead over his opponent, Jim Davis, a congressman, in the latest poll. Mr Crist is better known than Mr Davis, and better funded.

Other congressional races are unexpectedly troublesome for Republicans, made worse by the party's national malaise. Democrats have their eyes on two other seats besides Mr Foley's. In Florida's 22nd District, a gerrymandered ribbon along Florida's south-east coast, the Republican incumbent, Clay Shaw, is locked in a tight battle with Ron Klein, a Democratic state senator who agonises over rising insurance costs for homeowners and blunders in Washington. Another close (and expensive) race is along the west-central part of the state. The seat was previously held by Ms Harris, and has been a Republican stronghold.

As for Mr Mahoney, Republicans are not ceding the field altogether. Joe Negron, a state representative, quickly entered the contest. He is already knocking Mr Mahoney as a “John Kerry Democrat” (Mr Kerry recently campaigned with Mr Mahoney). But Mr Negron faces what some Republicans, including the House majority leader, John Boehner, concede is a fatal handicap: Mr Foley's name, not his, will be on the ballot in November. In a month, Mr Negron must persuade voters that votes for Mr Foley will be counted for him.

Republican politicians are not the only ones hard-hit by Mr Foley's debacle. Floridian newspapers are also under fire. Both the *Miami Herald* and the *St Petersburg Times*, the state's principal papers, had long ago seen Mr Foley's e-mail to the first page, asking for birthday-gift suggestions and a “pic”. Both failed to publish the information, concluding that the exchanges by themselves were odd but ultimately innocuous, and reasoning that because the boy's parents had asked for the matter to be kept quiet it would be wrong to do otherwise. Like the Republican House leadership, they now have a bit of explaining to do.

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Congressional pages

Summoned by bells

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Civics classes were never quite like this

THE requirements for being a page in the House or Senate are straightforward. You must be at least 16 years old, with decent grades; you have to be nominated by a member of Congress; and you need an all-consuming love of the legislative process.

That last condition is fairly testing. Still, several hundred high school students make the cut each year. They come to Washington and bunk in dorms. House pages live in a former convent, Senate ones in a converted funeral home. They attend classes early each morning before reporting to the Capitol for the day. There they answer phones and relay messages. Some nab “more exciting” jobs, according to James Kotecki, who used to be a page himself. Documentarians, “the most televised pages”, summon representatives to vote with an elaborate system of bells.

Far away from parents, drawing a salary and often unsupervised, pages have ample opportunities for mischief. Few take advantage. A handful have been expelled for drinking or smoking pot. But overall, they are a quiet bunch. As civics nerds, they may be constitutionally indisposed to high jinks. One of Mark Foley's teenage correspondents described himself as “sore from waltzing”. And pages have respectable goals. The programme looks good on college applications and gives aspirational types a chance to watch their heroes in action.

Some, of course, do more than watch. Mr Foley is not the first congressman to dabble in the kiddie pool. In 1983 the House Ethics Committee censured Dan Crane of Illinois and Gerry Studds of Massachusetts for their sexual relationships with 17-year-old congressional pages. Both men confessed, and Mr Crane cried. Mr Studds, however, was defiant. He said that the relationship was none of anyone's business, because 16 is the age of consent in the District of Columbia. The challenges of life are, he added, “substantially more complex when one is, as I am, both an elected public official and gay.”

A weaselly thing to say, but his constituents accepted it, re-electing him six more times. Massachusetts voters seem unfazed by sex scandals. Two years later, Ted Kennedy was caught in a supposed “waitress sandwich”. His alleged companion was Senator Chris Dodd of Connecticut—himself a former page.

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About sponsorship

Negative campaigning

The same to you, with knobs on

Oct 5th 2006 | WASHINGTON, DC
From The Economist print edition

The mid-term mud starts to fly

“THE facts are that since Bob Humpty went to Washington, more than 350m people around the world have died from various causes, including disease, famine, earthquakes and machete attacks. Coincidence? Not according to these realistic-looking headlines.” That attack ad was dreamed up by Dave Barry, a comedian. But are the real ones much better?

Their logic is often equally strained. For example: “During Deborah Pryce's congressional tenure, gas prices have more than doubled,” one learns from a website called www.badpryce.org. Deborah Pryce is the Republican representative for Ohio's 15th district. Oil traders rarely cite her influence when trying to explain why prices go up or down, but you never know.

With only a month to go before the mid-term elections, the slurs are splatting like tomatoes at a Spanish tomato-throwing fiesta. An early contender for the lowest-blow award is Vernon Robinson, the Republican challenger for a House seat in North Carolina, who produced a video alleging that his opponent, Brad Miller, “pays for sex, but not for body armour for our troops.” Mr Miller “voted to spend your money to study the sex lives of Vietnamese prostitutes in San Francisco,” not to mention “the masturbation habits of old men” and “something called the Bisexual, Transgendered and Two-Spirited Aleutian Eskimos, whoever they are.”

Well, sort of. Mr Miller did miss a vote on appropriations for the war in Iraq, but only because he was on his way to Iraq to visit the troops. As for the kinky stuff, Mr Robinson is referring to Mr Miller's vote not to micromanage the National Institutes of Health's budget for research into sexually-transmitted diseases. So perhaps he is not a callous pervert. But you should not vote for him anyway, because he wants to turn America into “one big fiesta for illegal aliens and homosexuals,” including those who burn the American flag.

In American politics, the constitutional guarantee of free speech trumps most other considerations, libel included. The only real check on attack ads is that if they sound too shrill, voters may recoil. But neither party seems unduly worried about this. In the early stages of the campaign, many candidates ran positive ads to introduce themselves. But as polling day nears, most ads—90%, by some guesses—have turned negative.

Republicans charge that Democrats are soft on terrorism, crime and border security. Democrats claim that Republicans are corrupt, incompetent, beholden to big corporations and marching in lockstep with President Bush. Some ads are paid for by the candidates themselves, but many of the most bare-knuckle messages are funded by independent “527” groups such as MoveOn.org (which bashes Republicans) and the Economic Freedom Fund (which bashes Democrats).

Such groups have mushroomed since a campaign-finance reform in 2002 curbed large donations to political parties. The money simply shifted to the 527s (the term refers to the relevant article of the tax code). For the parties, this is a mixed blessing. On the one hand, they have no control over what independent groups say on their behalf. On the other, they can plausibly distance themselves from the more underhand attacks on their opponents.

For example, MoveOn has released a series of ads in which four Republicans in marginal seats are described as “caught red-handed”. To illustrate their red-handedness, MoveOn paints their hands red. It also adds a gratuitous picture of Jack Abramoff, a convicted fraudster. Yet none of the four has done anything illegal.

Personal attacks have long been part of American politics. The Declaration of Independence had some choice things to say about George III. Federalists called Thomas Jefferson an “atheist” and his followers “cut-throats who walk in rags and sleep amid filth and vermin”. In the 1960s, a Democrat ad hinted that Barry Goldwater might start a nuclear war. Modern campaigns are probably no worse than the old ones, but several things have changed.

First, campaigns now wallow in cash—the two parties have spent $500m between them so far on this year's race, according to Political Money Line, a watchdog. Second, the proliferation of media gives campaigners more options for getting out their message, but makes it harder to be heard above the hubbub. Both parties try to create scandals by sending flunkies to film everything their opponents say or do, and then posting gaffes on the internet. This works—as George Allen, the junior senator from Virginia, discovered when he used a racial slur for the man filming him. It also kills spontaneity on the campaign trail.

Lastly, both parties try to find out as much as possible about individual voters so as to target them more precisely. If, for example, someone has signed a petition calling for a bond issue to finance local schools, a candidate might tell him that his opponent will cut spending on education. Distorting your opponent's record is easy: congressmen often have to vote yes or no to omnibus bills with hundreds of loosely-related provisions, so they can all be portrayed as having backed a provision that, on its own, they would have shunned. Voters know this, however, and are highly sceptical of what attack ads tell them.

The ads that work best are the funny or funky ones, because people remember them, argues David Mark, the author of “Going Dirty: the Art of Negative Campaigning”. For example, Michael Steele, a Maryland Republican running for the Senate, pre-empted his opponent's attacks with a chatty spot. “Soon your TV will be jammed with negative ads from the Washington crowd,” says Mr Steele. “Grainy pictures and spooky music saying: ‘Steele hates puppies.' And worse. For the record, I love puppies.” Then, with a puppy at his side, he offers some policy ideas. The Democrats responded in the same tone. “Michael Steele. He likes puppies. But he loves George Bush.”

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About sponsorship

Detainees

Cold comfort

Oct 5th 2006
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President Bush's new law on the treatment of terrorist suspects

AP

You may not have the body

AFTER more than three weeks of wrangling with enemies and allies alike in Congress, President George Bush on September 29th at last won approval for the legislation on terrorist detainees that he says is vital to save American lives. But it is unlikely to improve America's image around the world much. Not only does it permit the CIA to continue its harsh interrogation of suspected terrorists in secret prisons abroad, it also strips foreign detainees of one of the civilised world's most ancient legal protections—the right to challenge their detention in court.

Democratic efforts to limit the bill's measures to five years, to require frequent reports from the administration on the CIA's interrogations and to specify which interrogation techniques were forbidden were all defeated. Even some Republicans were appalled, particularly by the suspension of habeas corpus. “I'm not going to support a bill that's blatantly unconstitutional...that suspends a right that goes back to [the Magna Carta in] 1215,” declared Arlen Specter, Republican chairman of the Senate Judiciary Committee—though he ended up voting for the bill after his amendment failed.

Many are already predicting a new challenge in the Supreme Court. In June, the court dealt Mr Bush a heavy blow by ruling that Common Article 3 of the Geneva Conventions, laying down minimum standards for the treatment of prisoners, applied to all detainees, whoever they were and wherever they were being held. The administration had previously argued that the conventions did not apply to al-Qaeda or other terrorist suspects, particularly if held outside the United States.

In a televised speech on September 6th, in which he confirmed the existence of the CIA's network of secret prisons for the first time, Mr Bush admitted that a “limited number” (an estimated 100 over the past five years) of “high-ranking” al-Qaeda and Taliban suspects had been subjected to “an alternative set” of “tough”, interrogation techniques—though not torture, he insisted. But the court's ruling had put into question the future of this programme, required to extract “life-saving information” from particularly recalcitrant detainees.

Following the transfer of the last 14 CIA detainees to Guantánamo on September 4th, there was now no one left in the programme, Mr Bush said. But he made it clear that he intended to restart it as soon as he got the necessary legislation to protect CIA agents from possible prosecution for war crimes. The new law does that. It bars the Geneva Conventions from being invoked against American personnel; gives the president power to interpret the “meaning and application” of the conventions; and authorises him to establish which interrogation techniques are permissible, though “a grave breach”, such as rape and outright torture, is banned.

It also authorises the trial of detainees accused of war crimes by the special military tribunals set up by Mr Bush in Guantánamo Bay. (Of the 770 men who have passed through the camp, only ten have so far been charged.) In June, the Supreme Court struck down the tribunals on the grounds that they had not been approved by Congress and did not provide the proper due process protections guaranteed by the Geneva Conventions. But human-rights groups complain that the reconstituted tribunals still allow hearsay and coerced evidence, and bar appeal to an independent court against conviction or sentence, even the death penalty.

The result of a last-minute deal between the White House and a group of Republican dissidents, including Senator John McCain, front-runner for nomination as the Republican presidential candidate in 2008, the new law marks one big advance on Mr Bush's original plans. Defendants will now be entitled to see all the evidence against them, though some of it only in “redacted” form. But that will be of little comfort to the mass of detainees who still face the prospect of languishing in Guantánamo without ever being charged or tried and without any possibility of challenging their detention.

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Murder in schools

The horror

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Much to mourn, little to learn

TO JOURNALISTS, three of anything makes a trend. So after three school shootings in six days, speculation about an epidemic of violence in American classrooms was inevitable, and wrong. Violence in schools has fallen by half since the mid-1990s; children are more than 100 times more likely to be murdered outside the school walls than within them.

Of course, that average is not wholly comforting. Most children who are murdered are murdered by someone they know. But most parents know with certainty that neither they nor their friends or relations are killers, so their worries focus on strangers. Their fears are inevitably stoked by the breathless coverage of school shootings.

On September 27th a 53-year-old petty criminal, Duane Morrison, walked into a school in Bailey, Colorado, with two guns. He took six girls hostage, preferring the blondes, molested some of them, and killed one before committing suicide as police stormed the room.

On September 29th a boy brought two guns into his school in Cazenovia, Wisconsin. Prosecutors say that 15-year-old Eric Hainstock may have planned to kill several people. But staff acted quickly when they saw him with a shotgun, calling the police and putting the school into “lock-down”. The head teacher, who confronted him in a corridor, was the only one killed.

And on October 2nd a 32-year-old milk-truck driver, Charles Roberts, entered a one-room Amish school in Nickel Mines, Pennsylvania. His suicide notes mentioned recurring dreams of molesting children, but it is unclear whether he did so. He lined the girls up, tied their feet and, after an hour, shot them, killing at least five. He killed himself as police broke into the classroom.

What to make of such horrors? Some experts see the Colorado and Pennsylvania cases as an extreme manifestation of a culture of violence against women. Both killers appeared to have a sexual motive, and both let all the boys in the classroom go free. But it is hard to extrapolate from such unusual examples, and one must note that violence against women is less than half what it was in 1995.

Other experts see all three cases as symptomatic of a change in the way men commit suicide. Helen Smith, a forensic psychologist, told a radio audience “men are deciding to take their lives, and they're not going alone anymore. They're taking people down with them.” True, but not very often.

Gun-control enthusiasts think school massacres show the need for tighter restrictions. It is too easy, they say, for criminals such as Mr Morrison and juveniles such as Mr Hainstock to obtain guns. Gun enthusiasts draw the opposite conclusion: that if more teachers carried concealed handguns, they could shoot potential child-killers before they kill.

George Bush has now called for a conference on school violence. Will it unearth anything new, or valuable? After the Columbine massacre in 1999, the FBI produced a report on school shooters. It concluded that it was impossible to draw up a useful profile of a potential shooter because “a great many adolescents who will never commit violent acts will show some of the behaviours” on any checklist of warning signs.

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Cheap drugs

Popping pills

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Good news for anyone who has ever got medicine from Canada

AS CONGRESS adjourned for the mid-term elections, some last-minute business was rushed through. There were votes in it, of course: old people's votes, which are well worth seeking.

The first measure, slipped in as an amendment to the homeland security appropriations bill, makes it legal for Americans visiting Canada to bring back a 90-day supply of prescription drugs for personal use. The second, made after prolonged pressure from a senator from Florida, is the decision to stop customs officials, from next week, seizing packages containing prescription drugs posted from Canadian pharmacies.

For years Americans living in border states have been slipping across to Canada to buy medicines at a fraction of their price south of the border. More recently they have also been buying those drugs over the internet, which can be done without exertion from their own front porches. By mid-2004 nearly 300 pharmacies were trading online, and sales to Americans are estimated to have exceeded $460m.

But all this was technically illegal, since American laws do not allow the import of most prescription drugs. Customs officers traditionally turned a blind eye when individuals—even greying busloads of them— carried personal supplies over the border. AARP (formerly the American Association of Retired Persons) continues to organise such bus trips. The internet pharmacies crossed their fingers and hoped drugs sent by post would also be let through. But their success prompted American drug firms, dismayed at being undercut by imported drugs and generic drugs that were still under patent in America, to restrict supplies to internet pharmacies in Canada and call for full enforcement of American laws.

The Food and Drug Administration (FDA) worried about the safety of drugs coming in from other jurisdictions. Canada is not the only country trying to tap the lucrative American market online. The FDA launched a campaign about dangerous drug imports, featuring a rather fearsome-looking snake coiling round a bottle of pills. Several well-publicised seizures of counterfeit drugs, some of them from Canada, further bruised the image of internet suppliers. Then, last November, American customs officials suddenly cracked down hard on prescriptions posted from Canada. An estimated 40,000 such packages have been seized in the past year.

Many Americans, of course, supported the Canadian pharmacies. Several cities and states attempted to source their drugs from Canada, despite strong FDA disapproval. Some listed reputable Canadian suppliers on their official websites. Nevada went as far as licensing four Canadian pharmacies so that state residents could buy their drugs from those stores. Nonetheless, cross-border sales suffered; by June 2006, by some estimates, sales had dropped to less than half the 2004 figure.

Now that restrictions have been lifted on personal imports of drugs and on mailed prescriptions, that trend is likely to change. But it will not reverse completely. A strong Canadian dollar, which has risen about 11% in the past couple of years to close to 90 cents in American money, has made Canadian drugs more expensive. And the passage in 2003 of the Medicare prescription-drugs act, providing coverage for many old people who had lacked it, has reduced demand. Canadian pharmacies may not be in for quite the bonanza they hope for.

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Obesity

California eating

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Even in the home of beach volleyball, obesity is on the rise

Eyevine

Working up an appetite

CALIFORNIA is supposed to be the Golden State of beautiful people, their bodies honed to perfection by 24-hour gyms, cosmetic surgery and “healthful” diets. Sadly, the image is yet another Hollywood illusion. In reality, according to a new study by the Public Policy Institute of California (PPIC), Californians are almost as fat, often grotesquely so, as the rest of burger-munching America. In 1990 some 10% of the state's adults were considered medically obese; by 2003 the proportion had more than doubled. Factor in the fat, as well as the gross, and only around half of Californians are of “normal” weight for their height.

How can this be, when the advertising hoardings promote stick-thin Paris Hilton and when Governor Arnold Schwarzenegger, a former Mr Universe, rails against junk food? One explanation, says the PPIC, lies in racial and ethnic differences: California's Latinos, who make up 35% of the population, and blacks (around 7%) are much more likely to be overweight than California's non-Hispanic whites (45%) or Asians (12%). For example, the average five-foot-four-inch (1.63m) white woman in 2003 weighed 149lb (67.7kg); her Latina counterpart 163lb; and her black counterpart 166lb. According to the “body mass index” used by weight-watch analysts, that means that all three were overweight, with the black woman only eight pounds away from obesity.

The PPIC study declines to speculate on the role of genetics in the differences. Rather, it looks at the part played by income and even zip codes. The income equation is straightforward: the poor eat a disproportionately large amount of junk food, and are mostly Latino and black. The zip-code notion is more subtle: poor areas have fewer supermarkets, with their greater choice of fruit and vegetables, and more convenience stores, with their narrower range. There is one extra factor: first-generation Latino immigrants may be poor, but they still tend to be healthier than whites. The trouble is that their descendants, adopting America's way of eating and living (for example, driving instead of walking), soon gain the kind of weight that leads to Type 2 diabetes—much more prevalent among Latinos than among non-Hispanic whites—and other health problems.

Can a price be put on all this extra flab? Five years ago America's surgeon-general estimated that excessive weight cost the nation roughly $117 billion in direct and indirect costs, from health care to lost productivity. One report last year reckoned the cost to California alone was $21.7 billion in 2000. Meanwhile, one thing seems probable: that cost will grow. After all, Latinos already account for 40% of

California's obese adults—and in another generation or so more than half of Californians will be Latino.

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About sponsorship

Lexington

Cross-eyed and clueless

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A new book lays the administration's weaknesses bare

SIR ISAIAH BERLIN liked to say of his Oxford college, All Souls, that the Fellows changed but the guests were always the same. This is even truer of Washington, DC. Presidents and their entourages come and go. But the guests at the political feast—from the talking heads to the lobbyists—stay the same.

There is no more illustrious guest than Bob Woodward. Ever since he helped to defenestrate Richard Nixon in 1974, Mr Woodward has been a sort of super-reporter—employed by the *Washington Post* to cultivate high-level contacts and churn out bestselling books. This week Mr Woodward described his work as “just reporting—I've done it for 35 years and sometimes it has an impact and sometimes it doesn't.” His latest book, “State of Denial”, is undoubtedly having an impact.

Mr Woodward's central argument will be familiar to Bush-haters the world over. The 43rd president is a lightweight who relies on gut instinct not reason and prefers feel-good rhetoric to serious analysis. He is incurious to the point of doltishness (David Kay, America's top weapons-inspector at the time, was shocked by how little he asked him about the failure to find WMD in Iraq). He is also optimistic to the point of delusion. When he was giving his second inaugural lecture on bringing the gift of liberty to the Middle East, his officials were calling Iraq a failed state. Mr Bush rules over a dysfunctional court, a place where everything is subordinated to keeping the president happy and the political base jazzed up. Mr Bush's advisers suppress the bad news about Iraq for fear of upsetting their boss—and swallow their doubts about Iraq for fear of being accused of not being team players.

Sometimes “dysfunctional” seems too weak a word. Steve Herbits, an adviser to Donald Rumsfeld, suggested that Paul Wolfowitz would make an ideal viceroy for Iraq—“His being Jewish is a plus: it's a reminder that this is not a war against religion.” Porter Goss, who for a time served as CIA director, frequently took Fridays off (he was only fighting a war against terror, after all). Dick Cheney was sure that two of the administration's worst disasters—Hurricane Katrina and the Harriet Miers nomination—would “turn out to be net positives for Bush”.

Mr Woodward's critics on both left and right have complained that this is all old hat. “We've read this book before,” says Tony Snow, Mr Bush's press secretary. But it matters, because Mr Woodward can hardly be classified as a Bush-hater. “Bush at War” painted such a flattering portrait of the great leader that the Republican National Committee sold it on its website. And it matters because the Woodward publicity machine is a mighty engine. “State of Denial” has already sold out its first printing of 750,000

copies, and Mr Woodward is omnipresent on cable TV.

Mr Woodward also knocks a few more nails into Mr Rumsfeld's coffin. He produces yet more examples of his bullying and boorishness—such as Mr Bush having to instruct him to return Condoleezza Rice's phone calls. But he adds new charges. Mr Rumsfeld lost interest in Iraq once the invasion was over (though he continued to stymie the State Department's attempts to revise interrogation policies). He kept his fingerprints off tricky decisions—an internal memo accused him of “rubber-glove syndrome”. He also borrowed a tactic from the left, blaming “the system” for his own failures. No wonder several of Mr Bush's closest advisers—including Laura Bush, Ms Rice, Andy Card, his then chief of staff, and Michael Gerson, his speech-writer—have tried to get him pensioned off.

Mr Rumsfeld is at least nearing the end of his career, if not as fast as one might like. Mr Woodward's other big target, Condoleezza Rice, is still in the middle of hers. Not long ago she was being touted as a potential president. But her star has been dimming since her lamentable performance during the Israel-Lebanon war, and “State of Denial” will dim it further. Mr Woodward quotes George Bush senior saying that she is not “up to the job” and Mr Kay describing her as “probably the worst national security adviser in modern times since the office was created” (sic).

Marching in the wrong direction

“State of Denial” also contains an explosive charge about September 11th. Mr Woodward claims that George Tenet, the then head of the CIA, and Cofer Black, his deputy for counter-terrorism, went to see Ms Rice, then head of the National Security Council on July 10th 2001, and warned her that “chatter” about an impending attack was too loud to ignore. Ms Rice gave them the brush off. This charge has produced a convoluted debate. Ms Rice first claimed that the meeting never took place. Then administration officials confirmed that it did indeed take place. Ms Rice then disputed the characterisation of the meeting: she was having regular meetings with Mr Tenet at that point. Whether Ms Rice is guilty of neglect is not clear. But at the very least Mr Woodward's revelations make it more difficult for the Bushies to point an accusing finger at the Clinton administration.

“State of Denial” could hardly come at a worse time for the Republican Party. Republican poll numbers recently ticked upwards as attention focused on war and terrorism. But the book threatens to turn that strength into a weakness. What is the point of being a resolute warrior if you are marching in the wrong direction? No wonder the Democrats held a press conference on the book before it was even published.

But the party's problems could last for more than the current election cycle. The striking thing about Mr Woodward's revelations is that they are so predictable. A mounting pile of books about the administration, such as Thomas Ricks' excellent “Fiasco”, reach the same conclusion. They make it more difficult for the administration to justify staying in Iraq for the rest of the Bush presidency. And they make it much more difficult for the Republicans to pose as the Daddy party—the party that keeps Americans safe in a world of terrorists and paedophiles.

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Brazil's elections

When victory spells defeat

Oct 5th 2006 | SÃO PAULO
From The Economist print edition

Lula is forced into an unexpected second round of voting

AP

Get article background

UNTIL the final days of the campaign, Luiz Inácio Lula da Silva appeared to be heading for certain re-election as Brazil's president in the first round of voting on October 1st. Then he made Brazilians angry. Last month members of his Workers' Party (PT) were caught with 1.75m reais ($800,000) in cash—the price of a dossier supposedly implicating José Serra, candidate of the centre-left Party of Brazilian Social Democracy (PSDB) for the governorship of São Paulo, in a long-running corruption scandal. Rather than apologise or explain, Lula ducked the final televised debate with his rivals. The day before the vote, photos of the piled-up cash appeared in the media. Voters hit back. Lula's first-place finish, with 48.6% of the poll, is really a defeat. He now faces an unexpected second round against Geraldo Alckmin, a former PSDB governor of São Paulo, who came just seven points behind and way ahead in morale and momentum.

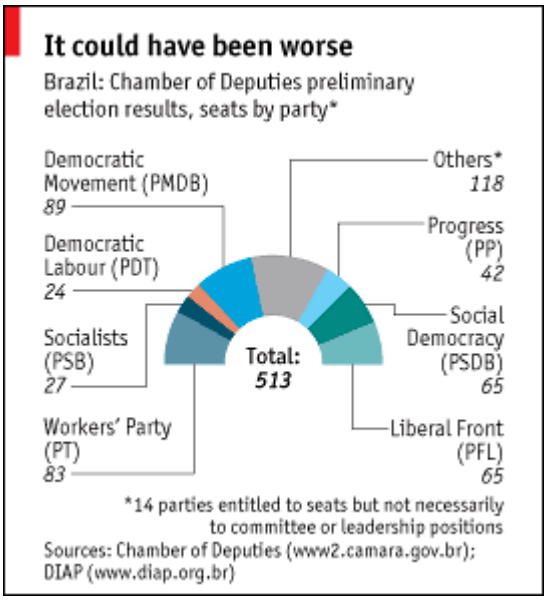
“Lula is still the favourite, despite the damage,” says Cristiano Noronha of Arko Advice, a political consultancy. The most recent poll, released before the vote, put Lula five points ahead in the second round, to be held on October 29th. Yet Mr Alckmin, who until a few months ago was barely known outside São Paulo and was seen as too bland to make an impression, now has a real chance to close the gap.

Born poor himself, Lula won over Brazil's poor masses by driving down inflation and expanding welfare. The poor north-eastern states voted overwhelmingly for him. Bahia, the most populous, surprised pollsters by evicting a governor allied to a political clan on the right in favour of one from the PT. But Lula did not please everyone. High interest rates and taxes and a strong real have held back growth, especially in the more prosperous south and the grain-growing centre-west. The fortunes of middle-class voters, those most apt to punish political corruption, stagnated. Lula appeared to have weathered a series of scandals that toppled his top advisers and the leadership of the PT, but the bungled attempt to smear Mr Serra reminded voters of his party's sorry ethical record. Mr Alckmin swept the south and the centre-west as well as winning his home state, which accounts for nearly a quarter of the electorate.

The second round is likely to be a clash of styles and accusations rather than one of ideas. Mr Alckmin is friendly to business and exalts efficiency in public spending. In São Paulo he reduced taxes, turned roads

over to private management and expanded investment—accomplishments that largely eluded Lula during his first term. He correctly identifies Brazil's overgrown public sector as the source of the economy's low growth and is keener than Lula to promote private investment in infrastructure, partly by “rescu[ing] the role of regulatory agencies”, which Lula has undermined. Lula tends to boast about what the state has done rather than what it encourages the private sector to do. Financial markets greeted Mr Alckmin's strong performance in the election by pushing up prices of Brazilian assets on October 2nd.

Yet Mr Alckmin is at pains to reassure voters that he will not roll back Lula's social programmes, while Lula is reinventing himself as an apostle of public thrift. The finance minister, Guido Mantega, has promised lower taxes and a cut in the government's non-investment spending as a share of GDP. Both candidates are coy about just how they would cut spending, avoiding subjects like pension reform.


It could have been worse
Brazil: Chamber of Deputies preliminary election results, seats by party*
Democratic Movement (PMDB) 89
Democratic Labour (PDT) 24
Socialists (PSB) 27
Workers' Party (PT) 83
Others* 118
Progress (PP) 42
Social Democracy (PSDB) 65
Liberal Front (PFL) 65
Total: 513
*14 parties entitled to seats but not necessarily to committee or leadership positions
Sources: Chamber of Deputies (www2.camara.gov.br); DIAP (www.diap.org.br)

Neither will have an easy time managing the new fractious Congress. Just seven of the 21 parties elected to the lower house appear to have crossed the new threshold of votes required for committee assignments and a reasonable share of free television time. That will prompt mergers among remaining parties, accounting for perhaps a quarter of the 513 seats, and more than the usual number of defections by deputies to stronger groupings. The PT defied predictions that its congressional strength would fall sharply. If Lula wins it will seek to patch together a majority from other leftist parties, the bulk of the Brazilian Democratic Movement (PMDB), now the largest party, plus assorted others. Its overall support base will be roughly the same as it was in the outgoing Congress, though it has fallen a bit in the Senate.

Mr Alckmin's lower-house coalition, if he wins, would be based on the PSDB and the Liberal Front Party but would otherwise resemble Lula's. In such a legislature either candidate could, with the help of state governors, probably make economic progress. But “neither will have the conditions to approve big structural reforms,” many of which require constitutional amendments, says Christopher Garman, a political analyst.

If Mr Alckmin is to beat Lula he will have to attract the bulk of voters who backed third candidates, especially Heloísa Helena, a left-winger expelled from the PT, and to peel away some of Lula's first-round supporters. Mr Alckmin is counting on regional allies who outperformed him in the election. That goes for Mr Serra, who won easily in São Paulo, and still more for Aécio Neves, who was re-elected as governor of Minas Gerais with 77% of the vote. Lula plans a similar strategy. And at the next debate, Mr Alckmin will not face an empty chair.

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Chile's schools

How to make them better

Oct 5th 2006 | SANTIAGO
From The Economist print edition

More money will not necessarily mean better standards

Get article background

"SKY-high copper prices; rock-bottom education!" read a student banner during a three-week sit-in by Chile's secondary-school pupils in May. Since then students, often backed by their teachers, have been staging sporadic demonstrations and strikes in pursuit of demands that the government use some of its record earnings from Chile's most valuable export on improving the dire quality of state schooling in South America's most successful economy.

As angry teachers and students once again descended onto the streets last week, the Geneva-based World Economic Forum released its latest *Global Competitiveness Report*, identifying Chile as the world's 27th most competitive economy—far ahead of the rest of Latin America—but just 76th for the overall quality of its educational system and 100th for its maths and science education. Other international studies likewise suggest that educational attainment in Chile, although not so different from that in other Latin American countries—slightly worse than in Argentina and Mexico, but better than in Brazil—is below that of many countries with a similar income level elsewhere.

But money may not be the only, or even the main, problem. By 2004 total spending on education—public and private—had reached 7.3% of GDP, up from 4% in 1990, putting the country on a par with many industrialised nations. But there has been no corresponding improvement in pupils' performance. Even among children from Chile's richest families, most of whom attend private fee-paying schools, educational standards are low by international standards. President Michelle Bachelet is now proposing to boost state funding for the poorest pupils by a half over the next four years. Under the scheme, costing an estimated $300m a year once fully operational, the current pupil funding of around $60 per month would rise to some $90 for the poorest pupils—provided their schools can show a measurable improvement in performance.

But in Puente Alto, which includes some of the poorest areas of Santiago, the capital, school directors suggest that more money, although welcome, is far from the top of their wish list. "We have all the infrastructure we need," says Paulina Barría, head of Los Pimientos primary school, surveying her modern, cheerful and scrupulously clean school, which looks almost opulent beside the shanty town where most of its pupils live. What she most wants, she says, is better trained and motivated teachers. And that, she adds, is not simply a matter of pay. Relative to national GDP per person, Chile's teachers' pay is already comparable to those in most industrialised countries.

It was not always so. During the 1973-90 Pinochet dictatorship teachers' wages dropped sharply, resulting in a fall in quality among those going into teaching. Mauricio Díaz, head of the Liceo Chiloé, also in Puente Alto, says he would sack two-thirds of his teachers if he could. But under a law introduced in the early 1990s, aimed at improving their status and career prospects, teachers are now virtually immovable while their pay is mainly based on length of service rather than performance. As a result, the country's municipalities, which run the state schools, find themselves saddled with ageing, often incompetent teachers and a mounting wage bill that, in Puente Alto, gobbles up 85% of the education budget.

The teachers are not entirely to blame for poor standards. Their work conditions are often difficult. Little time is allowed for class preparation, and many, particularly those who studied under the dictatorship, have received poor training. Hence their opposition to a new teacher-assessment programme, under which those who fail to improve could be sacked.

As well as boosting initial teacher training and in-service training—on which part of the copper windfall could usefully be spent—teachers need to be made more accountable for their pupils' performance, even if that means losing their jobs. But for this the government would have to face down the powerful teachers' union. And that, government officials privately admit, is a daunting prospect.

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The United States and Latin America

A partnership constrained

Oct 5th 2006 | WASHINGTON, DC
From The Economist print edition

Hold the marines, send in the OAS

IF THERE is one thing that Latin American politicians and pundits tend to complain about more than Uncle Sam's meddling in their affairs it is his apparent neglect of them. And ever since September 11th 2001 they have perceived just such a neglect. Leave aside that George Bush has acquired other distractions; the complaint overestimates the power of his administration to get its own way in foreign policy.

The first striking thing about the United States' policy towards Latin America just at the moment is its multilateralist tone—something for which it has not always been famous. Take the issue of how to contain Hugo Chávez, Venezuela's noisily anti-American president. In the past, the administration has been clumsy in its handling of him, failing to condemn a short-lived coup against him in 2002 and engaging in pointless verbal sparring. The policy now puts much more stress on working with allies in the Organisation of American States (OAS) both to try to support democracy in Venezuela and to blunt Mr Chávez's efforts to expand his influence.

In December Mr Chávez will seek a new six-year term in an election in which the fractious opposition has managed to unite behind a single candidate. Venezuela's willingness to invite the OAS and the European Union to observe the election will be the “indicator” of its fairness, says Thomas Shannon, the State Department's top diplomat for Latin America.

To the anxiety of some in the Bush administration, Mr Chávez's friend, Daniel Ortega, the Sandinista leader who was a foe of Ronald Reagan in the 1980s, leads the opinion polls for Nicaragua's presidential election next month. American officials make no secret of their preference for other candidates. But, as they hope to do in Venezuela, they are relying on an OAS observer mission, in the hope that it will neutralise the apparent control of the electoral authority by Mr Ortega and his allies.

The main thrust of the administration's policy in the region, according to Mr Shannon, is to work with other countries to consolidate democracy, broaden economic opportunity and fight terrorism and drugs. “The vast majority” of countries “can fit into the category” of partners in this, he says. So far, they include Bolivia under the government of Evo Morales, a socialist president of indigenous descent and another ally of Mr Chávez. “We've established a good dialogue with them on the important issues,” Mr Shannon says. “Bolivia can either be a South Africa or a Zimbabwe—it's still in the balance and that's why engagement is so important.”

Yet when it comes to the things that Latin American countries want from the United States the Bush administration is sometimes a prisoner of Congress. Take Mr Bush's plan for an immigration reform combining tighter border security with steps to encourage legal migration. Congress has passed only the first half of that proposal and, with an eye on next month's mid-term elections, the Senate has now approved a House proposal to build up to 700 miles (1,100km) of fencing on America's southern border.

The same goes for trade. Under a 1991 trade law designed to stimulate alternatives to drugs, the Andean countries sell duty-free several billion dollars' worth of “non-traditional” exports to the United States a year, ranging from Ecuadorean flowers to Peruvian asparagus and Bolivian textiles. The law expires on December 31st. Peru and Colombia have negotiated free-trade agreements as a replacement. Yet sources on Capitol Hill say that these will not be discussed until next year. Rising protectionist sentiment means their approval cannot be guaranteed, especially if the Democrats win control of the House of Representatives next month. Nor is it clear whether trade preferences for Bolivia and Ecuador will lapse or be renewed.

In these matters, Congress often follows rather than leads public opinion. “Domestic politics are the

dominant factor influencing policy towards Latin America," says Peter Hakim of the Inter-American Dialogue, a Washington think-tank. He notes that the power of the farm lobby means that the trade agreements with developing countries in Latin America are "ungenerous" with little scope for concessions. In its battle with Mr Chávez for the hearts and minds of Latin Americans, the United States sometimes undermines its own best efforts at being a good neighbour. The lesson for Latin American governments is to pay as much attention to Congress as to the White House.

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Argentina and Uruguay

Arm-twisting

Oct 5th 2006 | BUENOS AIRES
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A new turn in the paper-mill border dispute between the two countries

AFP

Due to resume?

JUST last month the bitter border dispute between Argentina and Uruguay, supposedly two of Latin America's closest allies, appeared to be drawing to a close. The erection of the two giant cellulose factories on the Uruguayan side of the river dividing the two countries looked set to proceed after two court rulings in Uruguay's favour. But now, in a big setback for Uruguay, ENCE, one of the two companies involved, has announced that it is abandoning construction of its plant on the contested border site, raising the prospect of renewed protests over the other factory.

The project involves a total planned investment of $1.7 billion, representing 10% of Uruguay's GDP. Although ENCE has said it will build its factory on a new site in Uruguay, few Uruguayans believe it. Ever sensitive to perceived bullying by their overbearing neighbour, the latest dramatic twist to the drama, for which they blame Argentina, has left them angry and resentful. It could even drive them out of Mercosur, the regional trade block to which both countries belong, and into the arms of the United States.

Fearing the environmental damage the paper plants might cause, Argentines on the river have been demanding a halt to their construction. Protesters in the border town of Gualeguaychú have blocked a busy shared bridge linking the two countries for a total of 62 days so far this year. Although such blockades are a crime in Argentina, the government declined to intervene. Unable to reach a negotiated settlement, both countries turned in exasperation to the courts.

Argentina sued Uruguay in the International Court of Justice, arguing that it had breached a treaty obligation to consult before doing anything that might affect the river. But in July the court rejected its request for an injunction to stop construction of the plants. Uruguay took its case to Mercosur, arguing that Argentina had failed to take action to ensure the free circulation of goods and services. Its ruling last month again went against Argentina. It looked as if plucky little Uruguay had won the day.

But ENCE's about-turn has called the whole project into question again. According to Juan Luis Arregui, ENCE's president, the town in which the factories are being built lacks sufficient infrastructure to support the lorries needed. But the Spanish company has known for years that its factory would be just 6km (4 miles) from the one being built by Metsa-Botnia of Finland and, as recently as this May, was still vowing that it would never move from the riverside site.

A more likely explanation is that Mr Arregui, who is known to have met with Argentinian officials in June, has come under pressure. Argentina's government has certainly shown no reluctance in wielding its formidable array of regulatory powers against other private companies; and, in the run-up to next year's presidential elections, its president, Néstor Kirchner, is ever eager to put on a show of strength. But the move may backfire. Scenting victory, Gualeguaychú's activists are now considering resuming their blockades.

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India and Pakistan

Bomb-blast diplomacy

Oct 5th 2006 | DELHI AND SRINAGAR
From The Economist print edition

AFP

Cross-border terrorism still undermines a shaky peace process

Get article background

IT IS hard to be on good terms with the neighbours when they keep blowing up your house. Yet, since 2003, India has sought to make friends with Pakistan while continuing to accuse it of abetting hideous bomb attacks in its cities. Pakistan brushes these accusations aside, while at the same time promising not to allow its soil to be used as a base for terrorism. This attitude makes the bombings seem an insuperable obstacle to peace. They may yet prove so. But they have at least become central to a peace process often marked by bickering over more trivial matters.

When a co-ordinated bomb attack killed more than 180 people in Mumbai on July 11th, Indian officials and politicians were swift to blame it on the Pakistan-based militant groups Lashkar-e-Toiba (LET) and Jaish-e-Muhammad (JEM). Last month Manmohan Singh, India's prime minister, gently fretted that the Pakistani government “has not done enough to control these elements.” On September 30th the Mumbai police went much further. They said the attack had been “planned” by the Inter-Services Intelligence agency (ISI), Pakistan's military-intelligence outfit, and carried out by LET and JEM. Far from merely turning a blind eye to cross-border terrorism, the Pakistani government, in the police's view, was the instigator.

This is an immediate test for an agreement reached in Havana last month between Mr Singh and General Pervez Musharraf, Pakistan's president. The official “dialogue” between their countries had been stalled since the Mumbai bombing. To provide a pretext for resuming it, the two leaders decided to form a vaguely-defined joint “anti-terrorism institutional mechanism”. This, in a sense, will call both sides' bluffs: India will have to produce evidence of Pakistani guilt; Pakistan will have to refute it—or act on it.

But the precedents for such co-operation are not good. In the past few weeks an Indian court has been delivering its long-delayed verdicts on the defendants accused of an earlier co-ordinated bombing in Mumbai, in 1993, in which more than 200 people were killed. It was blamed on an alliance of the ISI and leading dons in the Mumbai mafia, who are believed to have since taken refuge in Pakistan. India has demanded their extradition. Pakistan has ignored this request, and fibs about the gangsters' whereabouts.

Death by hanging

A third bomb attack, similarly blamed by India on Pakistan, has also returned to haunt efforts at reconciliation, especially over Kashmir, the core of the two countries' dispute. This is the suicide attack in December 2001 on India 's parliament in Delhi, in which 14 people were killed. The attack did more than any other act of terrorism to bring the two countries to the brink of war. The five attackers were all killed at the time. But others involved in the conspiracy have been tried. On September 26th one of them, Afzal Guru, was sentenced to death, and the date of execution set for October 20th.

He is a Kashmiri, from Sopore in the Indian-controlled part of the divided territory. In Kashmir the death sentence has been greeted by big protests. Many Kashmiris believe he is innocent, and are incensed by the (very rare) imposition of the death penalty and by the date fixed for its execution: the last Friday of the holy month of Ramadan.

Kashmir, India's only Muslim-majority state, has endured 17 years of brutal insurgency and repression. Many there see the ruling on Mr Guru as a deliberate affront not just to their secessionist hopes—many separatist politicians having championed his cause—but also to their religion. With Kashmiris weary of the war and Pakistan trying to make peace with India, separatist politicos had been squabbling among themselves and losing popularity. The issue has been a godsend for them, and even mainstream politicians have sought to have the death penalty overturned.

Mr Guru's family has appealed to India's president for mercy. That may avert the immediate crisis because the hanging will be delayed so long as he is considering their petition. But with the government already under fire from the opposition for being “soft” on terrorism, it would be unhappy if the president spared Mr Guru.

A further worsening of anti-Indian sentiment in Kashmir is another reason for pessimism about the Indian-Pakistani peace process. It will encourage those in Pakistan who have been stoking the insurgency, as both a Kashmiri “freedom struggle” and a low-cost proxy war against India. Certainly, hardliners in India, convinced that Pakistan is irredeemably wedded to the Kashmir insurgency and to causing terror in Indian cities, think the peace process is doomed.

Yet there are a few optimists. They say that, at least in part because of Pakistan's efforts to restrain the terrorists, the violence in Kashmir, has abated—despite a suicide attack in Srinagar, the capital, on October 4th. Fewer than 900 people have died so far this year, compared with twice that number in both 2005 and 2004. General Musharraf, they argue, is, despite his self-congratulatory new memoirs (see article), isolated politically and under pressure from insurgents in Baluchistan. He needs peace with India for the kudos it would confer and to free his army for domestic conflicts. Reining in the terrorists is so much in his interests that he may even make a serious stab at it.

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Nepal

Judged by the people

Oct 5th 2006 | NEPALGANJ
From The Economist print edition

The Maoists grow stronger

Chettri dispenses Maoist justice

JUDGE ANIL CHETTRI seems a moderate sort of chap to be running a Maoist “people's court”, and the court seems popular with the villagers of Kohalpur, in western Nepal. In the past three months it has heard 471 cases. Most involved small disputes over land and money, but a spicier example last week concerned polygamy. Giving evidence for the defence, a priest noted that the god Krishna had 16,000 wives. Reflecting later on the case, Judge Chettri said: “We learned how to do this work by living among the people.”

People's courts, which have mushroomed across Nepal in recent months, are only one sign that the country's Maoist rebels are getting more organised—and that the government is failing. While Judge Chettri passed judgment in a humble shack, Kohalpur's brand-new courthouse was closed for a two-week holiday. Even open, it sees scarcely more action: the most trivial cases can take years to be resolved in Nepalese courts, which are plagued by incompetence and corruption.

After a decade-long struggle, the Maoists control much of Nepal's countryside. In some places they collect taxes, award contracts and provide basic health care and relief, albeit limited, to victims of flooding. In April, in an alliance with the democratic parties, they led popular protests against the autocratic King Gyanendra, forcing him to cede power. The democrats then formed a coalition government, and promised peace talks with the rebels. But the talks have since been delayed several times, since the politicians can agree on almost nothing.

In the meantime the state is hardly functioning. Many policemen, for example, are sitting on their hands rather than enforcing the law until they see what kind of government will emerge. This has been a boon for the Maoists. Their charismatic leader, who is known simply as Prachanda, is arguably the country's most popular politician now. Not that he is blameless in Nepal's continuing meltdown. By creating a parallel administration, the Maoists aim to undermine the state. Moreover, some of their judicial practices are savage. Last week an alleged kidnapper was beaten to death in Maoist custody; the rebels insisted they had hardly hit him when he had a heart attack.

A swift end to the impasse looks unlikely, and impatience with the government is growing. Until the government can re-establish itself, the Maoists will continue to grow stronger. No one doubted Judge Chettri when he told a defendant: “Don't think that this court will be closed. Don't think that if the peace talks break down we will go to the jungle. The reactionaries will go to the jungle.”

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Thailand

Returning to democracy

Oct 5th 2006 | BANGKOK
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Some time, in some form

AP

General Surayud contemplates the mess

STAGING a bloodless coup to overthrow the government of Thaksin Shinawatra was, relatively speaking, the easy bit. Now Thailand's military chiefs face the more difficult job of honouring their promise to restore democracy. They started, on October 1st, by appointing as interim "civilian" prime minister General Surayud Chulanont, a former army commander who retired from the service in 2003. He is respected for having rooted out corruption in the armed forces and for being a devout Buddhist. By choosing one of their own, however, the generals have only added to the doubts about whether they really intend, as they said, to let go of their new-found power.

In 1992, a year after Thailand's last coup, when troops fired on pro-democracy protesters, General Surayud commanded a special-forces unit that took part in the suppression. But he was widely believed when he insisted that he had not ordered his soldiers to shoot. All in all, he said, the experience convinced him that the army should not be involved in politics.

Before appointing the general, the junta and its officials had hoped that foreign criticism of their coup was subsiding. A senior Thai diplomat played down America's decision to suspend $24m in military aid, arguing that this was simply the "mandatory minimum action" required under American law. That may be wishful thinking. A White House statement on October 3rd said further sanctions were being considered. The statement also demanded the swift restoration of civil rights, "noting" rather than welcoming the appointment of the new prime minister. The coup has probably also killed a proposed free-trade pact with the United States: America will negotiate such an agreement only with an elected government, and Thailand will not have such a government until after the expiry next July of George Bush's permission from Congress to strike such deals.

General Surayud has begun choosing a cabinet. This will consist mainly of technocrats such as Pridiyathorn Devakula, the central-bank governor, who is tipped for finance minister. The new cabinet is to run the country while a new constitution is written and put to a referendum. Then, around a year from now, elections will be held. Even if the generals let the cabinet do its job without meddling, this plan could face disruption. Though the junta will have a strong hand in selecting the constitution's authors, the process could easily descend into squabbling, causing the timetable for elections to slip. A pro-democracy movement is already stirring, and bigger protests are likely after the junta lifts its restriction on political gatherings.

Another danger, from the opposite direction, is that having been rid of an autocratic and allegedly corrupt machine-politician, many Thais will swallow the idea that their country would be better off without politicians altogether. The junta shows signs of thinking this way. It has banned anyone who has belonged to a political party in the past two years from the constitution-writing committee. Meanwhile, the country's two main parties are in poor shape and no position to answer back. Mr Thaksin's Thai Rak Thai (TRT) has no leader now that the former prime minister, who is currently exiled in London, has resigned from the job. Many other senior figures have quit the party, hoping to escape the consequences of a new law that bans from politics for five years the officials of any party dissolved for electoral fraud. TRT was being prosecuted for this before the coup, and the case is almost certain to be revived.

The second party, the Democrats, under their well-liked but ineffectual leader, Abhisit Vejjajiva, have performed lamentably during Thailand's long crisis. They have mostly sat dumbly, showing no sign of being capable of leading the country. And they too face dissolution for alleged fiddling in an election in April. Unless one of the parties can reassert itself, the scene may be set for a return to the weak, short-lived coalition governments seen before Mr Thaksin came to power. This would make it easy for the country's traditional elite, centred around King Bhumibol Adulyadej, and including the senior army officers who instigated the coup, to reassert themselves. It would not be much of a “return to democracy”.

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Indonesia

Muddy waters

Oct 5th 2006 | PORONG, EAST JAVA
From The Economist print edition

Reuters

What caused an environmental disaster in East Java?

FOR the past four months, a steady flow of hot and noxious mud has erupted from the earth, swamping villages, factories and rice paddies near Indonesia's second-largest city, Surabaya. Four villages, 20 factories and about 435 hectares (1,075 acres) of farmland have so far been submerged and 13,000 people have been evacuated from the area. Despite the hasty construction of a network of earthen dykes, in an effort to contain the muddy seepage, 12 more villages are in pressing danger of being swamped. A team of European scientists which visited the scene last month said the mud-flow could continue for decades—and may be impossible to stop.

A seismically-active archipelago, Indonesia is used to geological crises. But the mud-flow is also causing political tremors. It erupted 150 metres from where a gas company called PT Lapindo Brantas was drilling a 3km exploratory well. The company is controlled by the family of Indonesia's powerful chief welfare minister, Aburizal Bakrie. It has not accepted that it was responsible for the eruption, and it is by no means clear that it was. But some experts have alleged that the company was using unsafe drilling methods, including failing to encase properly the exploratory shaft, and that this could have contributed to the disaster. Another company involved in the drilling, PT Medco Energy, has accused a drilling subcontractor called Federated International (2000)—one of whose directors is a nephew of Mr Bakrie — of “gross negligence”. A criminal investigation into the causes of the disaster has made slow progress. This is a bit surprising, since nine employees of the drilling firm and of Lapindo have been declared official suspects.

Despite its denial of responsibility, Lapindo has so far spent more than $75m on compensation, containment and clean-up costs arising from the mud-slick. It is trying to staunch it by pumping concrete into the breach, and by drilling four new shafts. But it probably stands little prospect of success. Adriano Mazzini, a geologist from Oslo University who was among the European team of experts, said it could take “one, ten or 100 years” for the underground pressure that is causing the eruption to be released. Until then, he says, “It will be very, very difficult” to stop it.

The final costs of the disaster could run to hundreds of millions of dollars. The mud-flow is accelerating; it is currently at over 125,000 cubic metres a day—enough to cover a football pitch in about 15 metres of muck.

Sensing that the crisis was getting out of hand, Indonesia's central government took over managing it last month, but ordered Lapindo to continue paying for the operation. The government has decided to try to divert the mud into the sea, 15km away, through a local river. Environmentalists say that this threatens to cause a second disaster, because the untreated sludge will do dreadful damage to sea life,

and thereby also harm the livelihoods of millions of people living on Java's eastern coast.

Meanwhile, to the fury of those who suspect the alleged wrong-doers might not be held to account, the government is expected to announce that it will pay for the crisis-management operation if Lapindo's owners go bankrupt because of it. Indonesia's taxpayers would then be left with a massive bill for a mess that they played no part in creating.

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Japan

Blue-sky development

Oct 5th 2006 | TOKYO
From The Economist print edition

Attempts to revive what was once the heart of Tokyo

OF JAPANESE woodblock prints, perhaps the most admired are *ukiyo-e*, “pictures of the floating world”. Produced in great numbers between the late 17th and mid-19th centuries, they celebrated the blooming of metropolitan life in Edo, present-day Tokyo. A common subject of these works was Nihonbashi, the bridge halfway between Edo Bay and Edo Castle, now the imperial palace. Nihonbashi was not just the merchant heart of a city crisscrossed by waterways and, with a population of over 1m, more teeming even than Hogarth's London; it was also a pleasure district of teahouses, Kabuki theatres and courtesans. But, fans of *ukiyo-e*: make no pilgrimage to Nihonbashi today, for you will despair.

Nihonbashi's original wooden bridge, built in 1603, was replaced only in 1911 by a stone version. This survived the great 1923 earthquake (though the fish market next to it, the world's biggest, was moved soon after to its present site at Tsukiji, starting the area's decline). It survived, too, an American firebombing on the night of March 9th 1945, which destroyed much of the rest of the city. But it was no match for post-war urban planners. In a rush to improve transport and the flow of traffic in time for the 1964 Tokyo Olympics, the government filled in rivers, or threw up elevated roads over them.

Nihonbashi, once the point from which all distances in the realm were measured, now sits oppressed under an eight-lane expressway. Shigeru Ito, professor of land planning at Waseda University, lists this as the country's greatest eyesore in a report called “Ugly Japan”. Heaven knows there are contenders for the title, from garish love hotels to concrete-smothered shorelines. The tide, though, may be turning. Last year Junichiro Koizumi, then the prime minister, commissioned a panel headed by Mr Ito to look at ways of restoring a blue sky over Nihonbashi. The panel delivered its report last month: it recommends burying 2km (1¼ miles) of expressway underground, and creating space along the river for waterside life—something unknown to modern Tokyo. As he prepared to leave office, Mr Koizumi said he personally approved of the plan.

Yet it presents an enormous engineering challenge. For one thing, half-a-dozen underground lines crisscross the area, so the expressway would have to be put in the sliver of land just above them. A mixture of public and private money is being sought. The cost of the expressway alone might be ¥400 billion-500 billion ($3.4 billion-4.2 billion).

It may be years before the plan is officially approved. But pollution-chewing microbes have already been introduced into the river. And lovers of Nihonbashi bravely predict that the planned prettification will mark the point when the country with the rich world's most hideous buildings starts to become less ugly.

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China

Football code

Oct 5th 2006 | BEIJING
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Corruption in football clubs—and the country at large

STARVED of free political debate, the Chinese people have found in football a convenient cover to discuss their troubles. Like the country itself, Chinese sport is riddled with corruption, and fans are not inhibited in suggesting ways of tackling it.

On September 30th the police and the China Football Association (CFA) announced the formation of a task-force to rid football of the illegal gambling that has fuelled rampant match-fixing by corrupt players and referees. The problem has devastated the country's favourite sport, emptying stadiums and deterring sponsors. Football fans have been encouraged to call a police hotline or send an e-mail to the task-force if they suspect cheating.

This crackdown is not the first. Last year hundreds of people were arrested and numerous websites closed in a campaign against online gambling. Yet it proved little deterrent during this year's World Cup in Germany, which China did not qualify for. The contest saw a massive upsurge in the crime. In August the police reportedly began sending officers to football stadiums. This drew withering commentary from a website run by a provincial party committee, which noted that match-fixing could hardly be spotted from the stands.

The problem, many say, is the CFA itself, which though not technically part of the government is controlled by the General Administration of Sports, a government ministry. The CFA's operations are subject to little public scrutiny. Football clubs complain that it ignores their interests. The solution some newspapers suggest would be an independent governing body for the sport.

A book published earlier this year by a former top sports official in Zhejiang province, Chen Peide, has attracted widespread attention with its exposé of corruption in Chinese football. “Many corrupt phenomena in China can be blamed on corruption within the [government] system,” Mr Chen was quoted as saying in a review published by a state-owned newspaper. He is one of those advocating that football be freed from the government's grip.

In Shanghai, meanwhile, China's leaders are grappling with the biggest case of alleged corruption within the ranks of the Communist Party in recent years. Few dare to suggest that what the party needs are independent checks and balances. But that is precisely what anyone reading the sports pages might think.

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Correction: Poverty in Indonesia

Oct 5th 2006

In our September 14th story "Always with them" we printed incorrect data. This suggested that Indonesians are poorer than they are. At purchasing-power parity, 10m Indonesians live on $1 a day, and 100m on $2 a day. Sorry.

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Iran's nuclear strategy

Making uranium while the sun shines

Oct 5th 2006 | TEHRAN
From The Economist print edition

Iran's ruling clerics are too pleased by their good fortune to seek a deal

Eyevine

WHEN it comes to throwing dust into the eyes of competitors, and rosewater over a favourite, the Iranians are world-beaters. On October 3rd, as the five permanent members of the UN Security Council steeled themselves to think about imposing sanctions on Iran for failing to suspend its uranium-enrichment programme, the Iranians proposed, out of the blue, that one of the five, France, lead a consortium to enrich uranium on Iranian soil. In Iranian theory, such a scheme would allay the suspicions, shared by America, the European Union, Israel and many others, that Iran plans to use enrichment technology to make bombs. In practice, distrust of Iran's intentions runs far too deep for such a scheme to work.

Britain, France and Germany, the countries that have invested most in a tortuous negotiation process that started in 2003, have been here many times before. Last winter months were lost to Iranian humming and hawing after Russia proposed that it enrich uranium on the Iranians' behalf. They eventually said no.

More recently the Iranians glided past a Security Council resolution giving them until August 31st to suspend enrichment, by intimating—typically at the last minute—that they might do so during a new round of negotiations. With that gambit, they emboldened Russia and China, two permanent members of the council, to reiterate their long-standing opposition to the UN sanctions that the Bush administration favours, and the deadline slipped.

Since then Javier Solana, the EU's foreign-policy chief, has been trying to pin down exactly what the Iranians mean. Easier said than done; when he met Ali Larijani, Iran's top nuclear negotiator, last month, Mr Larijani was less keen to discuss suspension than where the proposed talks might take place, and between whom. Mr Solana concluded this week that Iran was not prepared to suspend enrichment. In that case, said Condoleezza Rice, America's secretary of state, on October 2nd, “then we will go to the Security Council for sanctions.”

If punishment comes, it is likely that it will be, in the words of a European envoy in Tehran, “symbolic”, at least at first. A hardening of existing restrictions on nuclear transfers to Iran may be complemented by new limits on missiles and other military sales—assuming that the Russians, who have built Iran's sole, yet-to-be-commissioned nuclear reactor, and recently sold the country a missile defence system, agree. But no one yet expects commercial sanctions of the kind that would hurt Iranian consumers or manufacturers.

Citing America's avowed reluctance to alienate ordinary Iranians, Ms Rice has ruled out targeting Iran's imports of refined oil products. But American pressure is dissuading an increasing number of foreign firms, particularly those with interests in the United States, from doing business with the Islamic Republic. America is also reported to have persuaded several European banks to reduce their ties. Japan is close to allowing the collapse of a $2 billion deal to develop Iran's largest onshore oilfield. Its coffers bulging with oil revenues, Iran brags that it can go without.

France has received Iran's latest overture coolly; it is unlikely to delay discussion of sanctions for long. The Iranian offer is designed to nudge the French towards the Russian and Chinese position. On September 18th Jacques Chirac, France's president, said that he was “never in favour of sanctions”, and suggested, in contradiction of the EU's line, that a new round of negotiations could start before an Iranian suspension. Yet he claimed later to see “eye to eye” with George Bush.

France's turns, and Italy's intensified diplomatic efforts—its prime minister recently received Mr Larijani—may have the same cause. Both countries are currently committing biggish contingents to the peacekeeping force that is assembling in south Lebanon to prevent more fighting between Hizbullah and Israel. The French have painful memories of the killing of 58 French soldiers in Beirut in 1983—by Hizbullah, it is presumed. Mindful of Iran's guiding influence over Hizbullah, they and the Italians are reluctant, at least for the present, to antagonise the Iranians.

Third-world fun

All this is grist to the diplomatic mill being operated by Mr Larijani, and by his combustible president, Mahmoud Ahmadinejad (shown above, announcing that Iran had just enriched uranium). The president does not decide foreign policy, which is the province of the supreme leader, Ayatollah Ali Khamenei, but he sets the tone. That, as his speech to the UN General Assembly showed last month, has moved from Israel-bashing to broader, rabble-rousing third-worldism, and to overt hostility to a UN system that gives privileges to the council's permanent members.

Iran's ruling clerics are tactically canny. With their prestige enhanced by Hizbullah's perceived defeat of Israel, it might be thought that now would be a good time for them to press Mr Bush, whose designs in the Middle East and Afghanistan are acutely vulnerable to Iranian interference, for a deal on terms amenable to the Islamic Republic. But the Iranians, says another experienced European diplomat, “do not know how to use their good fortune.”

That was evident in their inept non-response to this summer's declaration by Ms Rice that America is ready to talk to Iran if it suspends uranium enrichment. Iran's higher echelons are said to be split over whether holding talks would be in Iran's interests, and, if so, whether suspension would be a fair price.

These divisions were exposed by the hostile reaction of some Iranian conservatives to last month's publication of a letter, by Ayatollah Ruhollah Khomeini, Iran's first revolutionary leader, shedding light on his decision to accept a ceasefire with Saddam Hussein's Iraq in 1988, after eight years of war. Containing an allusion to Iranian commanders' contention that Iran would need atomic bombs to win the war, the letter showed that discussion of nuclear weapons is not quite the religious taboo that the clerics say it is. But what Akbar Hashemi Rafsanjani, the former president who released the letter, wanted to show up was the failure of Iran's current leaders to follow Khomeini's example: they lack the strength to make a painful peace in the national interest.

Puffed up after its successes in Iraq and Lebanon, Iran's leaders may not see that, the more they stall, and the more America's allies prevaricate over sanctions, the closer America and perhaps Israel come to taking matters into their own hands and launching military strikes. Reaching out to America would take a vision, courage and authority that the post-Khomeini generation does not command. Far easier, while the sun shines, to enrich uranium.

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America and the Middle East

Friends see things differently

Oct 5th 2006 | CAIRO
From The Economist print edition

Arab leaders, like Hosni Mubarak, agree on America's aims but not how to get there

Reuters

IT ALL looked cordial enough as Condoleezza Rice toured the Middle East for the first time since this summer's nasty little war in Lebanon. The secretary of state, adhering to the Bush administration's habit of shunning leaders it doesn't like, talked only to those anointed as “moderates”. Even so, behind padded doors, some hard words were exchanged.

That is not surprising. The Middle East pot is more than ever brimful with sticky problems, ranging from Iran's nuclear ambitions, to the ongoing agony of Iraq, to the humanitarian disaster of Darfur, to the shaky peace in Lebanon, to turbulence in internal Israeli politics and, never-endingly, to the misery of Palestine. So fraught is the region that Ms Rice, who on her last, wartime, visit homilised over the “birth pangs of a new Middle East”, this time talked only of a “future Middle East” where peace, prosperity and democracy would prevail.

The secretary's tour took her to Saudi Arabia, then Cairo for a joint meeting with six Gulf foreign ministers, along with those of Egypt and Jordan, and then on for meetings with Israel's prime minister and the beleaguered Palestinian president. Her objective was to rally allies against what is seen as the mounting challenge of the “resistance” block made up of Iran and Syria, together with their sub-state clients, Hizbullah and Hamas, and, to some extent, the recalcitrant government of Sudan.

Once seen as weak and isolated, this block has been bolstered by Hamas's electoral win, Iran's nuclear obstinacy and the skill and determination of Hizbullah in holding off Israel's far more powerful army. Meanwhile, the whole notion of “resistance” to America's perceived desire to dominate the region has gained ground among the wider Arab public. While the Hizbullah leader, Hassan Nasrallah, and even Iran's president, Mahmoud Ahmadinejad, win popular acclaim as Robin Hood-like heroes, stalwart Arab “moderates”, such as Egypt's president, Hosni Mubarak and King Abdullah of Jordan, are tarred as American puppets.

Their sense of vulnerability to such charges explains why Ms Rice's reception in Arab capitals was relatively muted. Arab diplomats seemed as concerned to show they were not creating a new, pro-American coalition, and were not acting against anyone in particular, as they were to emphasise any positive result of their talks. Yet, aside from reflecting the current toxicity of America to Arab public

opinion, this coolness also reflected diverging priorities between America and its allies.

Most Arab regimes, for instance, fully share America's annoyance with Syria, whose meddling in Lebanon, and support for hardline factions within Hamas, are seen as damaging to stability. But whereas American policy has been to squeeze until Syria crumples, Arabs tend to accept that Syria has legitimate grievances. “We don't think Syria's bullying tactics should be rewarded,” says an Arab diplomat, “but you can't just besiege a country without providing some kind of exit option.”

No Arab leaders, except those of Syria, Hamas and Hizbullah, like the idea of a nuclear-armed Iran and they are disturbed by Iran's backing for militant Islamist groups. But what they fear more is a clash between America and Iran that could spill onto their turf—turf that is, in the case of several Gulf states, conspicuously dotted with American military bases. If the question is to secure the oil-rich Gulf against Iranian adventurism, insist America's Arab friends, a good first step would be to deny Iran and its rejectionist allies moral traction, by doing something about the festering Palestinian issue.

Ms Rice, aware of Arab impatience for some progress on Palestine, proffered some slim ideas, based on trying to empower President Mahmoud Abbas and persuading Israel to moderate its blockade (see article). Her Arab allies understand that such steps may be all that can be hoped for at present. At the same time, they have lost faith with the long-held American policy of pursuing peace by incremental confidence-building measures.

“No one has the political capital left to take even the smallest step,” says an Arab official in Cairo. The only way to move, he says, is to offer a vision for a comprehensive regional settlement that would include not only Israel and Palestine, but also Syria and Lebanon. Oddly, that is precisely the idea now being floated by the 135 former foreign ministers, heads of state and Nobel prize-winners from around the world who have signed a petition calling for a regional peace conference.

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The Palestinian Authority

King Mahmoud

Oct 5th 2006 | JERUSALEM
From The Economist print edition

America wants to bolster Mahmoud Abbas, but to what end?

Reuters

Abbas can give orders but who will listen?

WHEN she reached Israel at mid-week, Condoleezza Rice pressed the government to act on its promise last November to the Palestinian Authority (PA) to speed up the flow of goods and people in and out of the West Bank and Gaza. She also passed on the PA's request that Israel start transferring the hundreds of millions of dollars in tax and customs revenues that it collects for the PA, but has been withholding since Hamas took power.

Israel could use the Temporary International Mechanism (TIM), a scheme set up by the European Union in June for routing money directly to Palestinians via banks rather than going through the PA. TIM has worked better than expected: the European Commission this year is giving the Palestinians more money than it has before, despite having cut all its direct aid to the PA. Some 100,000 of the poorest now get hardship benefits from European countries. The screening mechanism to keep money from going to suspected terrorists has so far weeded out just one person.

The Americans still refuse to join the TIM club themselves. But they hope that concessions by Israel will strengthen Mahmoud Abbas, the Palestinian president, and, perhaps, eventually oblige Hamas to meet the American and EU conditions for getting full aid restored: recognising Israel, renouncing violence and honouring previous PA-Israeli agreements.

The pressure on Hamas is rising internally too. Some 60,000-70,000 public-sector workers, including most of the security services, still get no TIM money, and Israel's continuing blockade of, and military incursions into, Gaza have turned it into a seething pressure cooker. Strikes by unpaid workers turned this week into clashes between gunmen from Hamas and Mr Abbas's Fatah movement, which took 12 lives. And it was Hamas that blinked first, ordering its fighters off the streets.

The risk in American strategy is that everything depends on Hamas's choices. Mr Abbas may be president but, on paper at least, he is less powerful than Queen Elizabeth, who unlike him can dissolve Parliament, declare war and appoint the heads of the religious establishment. In practice, of course, she exercises her powers only on the advice of her government. But Mr Abbas is not much freer.

He can dismiss the PA prime minister (the law is vague about the cabinet), but any new government has to be approved by parliament, where Hamas has 74 of the 132 seats while Fatah has 45. Mr Abbas, like the queen, is notionally head of the armed forces, but legally most of the forces answer to the Hamas-run interior ministry, and, in practice, their loyalties are divided among several chieftains.

Mr Abbas can issue decrees, but only when parliament is not sitting; when it goes back into session, they become void unless it approves them. He said this week that months of talks on a unity government had broken down and a new cabinet was needed. But he cannot call an early election—and polls suggest that, if there were one, Fatah would not oust Hamas.

Qatar has now proposed a plan for a coalition government, headed by a neutral figure, that agrees to the conditions on recognising Israel and renouncing violence. But Hamas may find it more humiliating to cave in to such conditions than to quit the PA altogether. And if it quits, as this week's clashes suggest, Mr Abbas and any new government would be fearful of an all-out confrontation with Hamas.

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Iraq

Your man or his?

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Keeping an eye on the security forces

IRAQI officials can't win. If they attempt de-Badrification, they are accused of re-Baathification. For much of the past year Iraq's Sunnis have accused the Shia-led government of stacking the security forces with Shia militants—such as the Badr Corps and the Mahdi Army—using the police and ministerial guards as weapons in the country's sectarian warfare. The interior minister, Jawad al-Bolani, has not, they say, done enough to purge officers with ties to Shia militias. Now Shia parliamentarians are levelling the same charge against the Sunnis, calling for Mr Bolani's resignation on the ground that he is packing the police with ex-members of Saddam Hussein's ruling Baath Party.

Iraq's political parties work on the theory that if you don't fill the post with your partisans, the enemy will fill it with theirs. As a result, say American officers, they can judge the importance of a captured Sunni insurgent or Shia militiaman by the number of high-ranking Iraqi commanders calling up to demand his release.

To address this dilemma, Nuri al-Maliki, Iraq's Shia prime minister who has promised to reach out to Sunnis, this week put forward an initiative aimed at creating a less sectarian security force. It is by far the most detailed proposal for tackling sectarian violence since the national unity government took office in May.

The idea is to set up security committees with representatives from every important faction in every district of Baghdad, the current centre of sectarian violence. The committees would then supervise the activities of the security forces in the neighbourhood. Although, in theory, members of the public can go to their member of parliament if they believe that the police or army are failing to protect them, the new plan decentralises the process—and would allow for a much swifter response if people believed that the police patrols were actually assisting terrorists to abduct or murder their neighbours.

The initiative comes at a particularly tense time. Not only is it usual to see an increase of violence during Ramadan but this time the beginning of the Muslim holy month coincided with the alleged discovery of a plot that has sent an unusually pronounced shudder through Baghdad's political classes. According to the American army, the bodyguard of Adnan al-Dulaimi, a prominent Sunni politician, was arrested just before he could carry out a series of bomb attacks in the heavily fortified Green Zone, where parliament and much of the Iraqi cabinet is located. Although the Americans emphasised that Mr Dulaimi was not himself implicated in the plot, Sadrist deputies lost little time in accusing Sunni politicians of having links to terrorists. They also announced that former Baathists were plotting a coup.

With the violence on Baghdad's streets continuing unabated, the establishment of a handful of committees may seem far too little and too late. Some Iraqi politicians have said that it is merely window-dressing by a government that has run out of ideas. Others wonder how the plan could work on the ground: are there even neutral safe places where the committees could meet? But few Iraqi leaders are producing any ideas at all—other than to pack the security forces with their own members, and kick out everyone else.

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Zambia's election

The technocrat and the populist

Oct 5th 2006 | LUSAKA
From The Economist print edition

Election hiccups in Africa's copperhouse

AP

A middle-of-the-road voter

IT STARTED peacefully enough. On September 28th, Zambians trooped to the polls to elect their president, members of parliament and local councillors. Eager voters started queuing up as early as 3am, quietly waiting their turn. In Lusaka, Zambia's capital, most voters had cast their ballots by mid-afternoon. But a few days later, riots erupted in the city's poorer neighbourhoods. Michael Sata, the main opposition candidate, had lost his early lead, finishing with 28% of the vote. President Levy Mwanawasa had won a second and last term with 43%—a sharp improvement over his 29% five years ago—and secured a majority in parliament.

Mr Sata appealed for calm but still claimed that the election was stolen from him. The streets are now quiet and the allegations of fraud are being investigated. So far, the election's international observers remain confident that the voting will be shown to be transparent and the results honest. This is a sea change from the 2001 vote, which failed to get the nod from observers and was disputed in court. This time, the electoral commission was independent, procedures were improved, and candidates given more access to the media.

Mr Sata, promising more jobs and striking a nationalist chord with his anti-Chinese blast, spoke to an attentive audience. Though the country has remained remarkably stable for decades, its mineral riches—Zambia is Africa's largest copper producer—have been largely wasted, and most Zambians are very poor. Mr Mwanawasa's anti-corruption drive is bogged down in court and has achieved little.

A tireless politician and an unrepentant populist, Mr Sata has a reputation for getting things done. He lambasted Chinese, Indian and Lebanese traders, much to the delight of locals suffering from the competition. He said he would rekindle links with Taiwan, to the fury of China, which has its eye on Zambia's copper. Thousands flocked to his campaign rallies, mesmerised by promises to return Zambia to Zambians and put money in their pockets. But the opposition vote was divided among four candidates, and the constitution allows for only one round, making it difficult to dislodge the incumbent.

Mr Mwanawasa could not be more different. His last rally in Lusaka was well attended, but all the music, dancing and free T-shirts were not enough, once he had taken the stage, to keep his supporters awake. As he slurred his monotone words, the crowd yawned, and quickly thinned.

Style may not be his forte, but Mr Mwanawasa has successes under his belt. The economy, boosted by good rains, high copper prices and better policies is growing by over 5%. Inflation has dropped to single digits, its lowest level in decades. Government purse strings have been tightened, and donors, who praise Mr Mwanawasa's management, have written off most foreign debt. Money has gone on hiring teachers and doctors, and the government has encouraged tourism and agriculture in a bid to soften the reliance on copper.

But many Zambians still fail to feel any improvement. Poverty may be retreating, but change is slow, and two Zambians out of three still live on less than $1 a day. Most farmers rely on erratic rain for their survival. Large swathes of the economy are still informal, and jobs are scarce. Mr Mwanawasa now has five more years to deliver the bolder reform and faster growth to create the jobs that would give people a better chance of a decent life.

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Congo's election

Hold your breath

Oct 5th 2006 | KINSHASA
From The Economist print edition

The speeches are fierce, the times are tense

RATHER confusingly for a country held together by 18,000 UN peacekeepers, Jean-Pierre Bemba, one of the two contenders for the presidential run-off election on October 29th, has just presented a new coalition called Union for the Nation or UN. Mr Bemba's UN is a largely populist group united in its virulent opposition to his rival candidate, President Joseph Kabila.

Mr Kabila, easy favourite to win the race, has boosted his chances even further by securing the support of Antoine Gizenga and François Joseph Mobutu Nzanga, who came third and fourth in the first-round election in July. Since both men are from Lingala-speaking western Congo, they may succeed in adding a chunk of western votes to Mr Kabila's Swahili-speaking eastern support (the voting in July was mainly on ethnic and linguistic lines).

In this tense breathing-space before the vote, the country is relatively quiet, though on October 1st, for instance, there was a fierce clash between the fledgling national army and one of the armed groups that are still resisting government authority in the east. In the capital, Kinshasa, where three days of fighting greeted the announcement, in August, of a run-off election, people are visibly on edge. Mr Kabila, Mr Bemba and the peacekeepers have all beefed up their security in a city packed with armed men and their vehicles.

A suspicious fire on September 18th gutted two of Mr Bemba's private television stations, sparking demonstrations and adding to the candidate's woes: his helicopter was destroyed during the August fighting. Speeches are harsh, often along nationalistic lines. Foreigners are increasingly unwelcome. Your correspondent was attacked by a mob of Mr Bemba's supporters merely for turning up to cover a rally over the weekend. And many foreign families are being sent home ahead of the next stage of Congo's painful quest for democracy.

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Germany

Angela Merkel's not-so-grand coalition

Oct 5th 2006 | BERLIN
From The Economist print edition

Almost a year on, the wheels seem to be falling off

JUST over a year has passed since Germany's inconclusive election of September 2005, which after two months of hard bargaining led to a “grand coalition” between the Christian Democrats (CDU) and the Social Democrats (SPD). Next month the CDU leader, Angela Merkel, will mark her first anniversary as chancellor. Yet to judge from recent squabbles, her coalition is in danger of coming apart.

The press is now as negative as it was in the dying days of the government under Gerhard Schröder, Ms Merkel's SPD predecessor. Both parties have slumped to 30% in the polls. Although a majority of Germans still think that Ms Merkel is doing a good job, only a third now approve of her government. This is happening even though the economy has picked up. Growth could reach 2.5% this year, and unemployment is down by nearly 400,000 on a year ago, to some 4.4m. Given the economic news, what explains the reversal of political fortunes?

In one sense, it is a simple case of the pendulum swinging back. Earlier this year, Germans were in love with Ms Merkel: no chancellor was ever so popular after so short a time in office. Promising a calmer style of government and cutting a good figure on her trips abroad, she managed to position herself as an anti-Schröder. But this honeymoon was bound to end.

What has turned it into a backlash against the government is the ambivalence of the electorate—the cause of last year's inconclusive election. Germans grasp the need for reform, but they want it to be orderly and painless: an impossible hope. Ms Merkel's style is also a problem. She seems to have a good mix of firm convictions and tactical flexibility. “Let us risk more freedom,” she said in her first speech as chancellor; as a physicist, she also sees political configurations as an experiment in which she lets different forces play out before intervening. She talks of underpromising and overdelivering.

Alas, recent months have shown that Ms Merkel puts aside her convictions too easily. She called an anti-discrimination law a bureaucratic nightmare, but accepted it as part of a political deal. In place of deft interventions, she has let policy differences get out of hand. Far from underpromising, she has oversold some reforms, notably in health care. The coalition's decision-making is chaotic, producing compromises that leave nobody happy.

The prime example is health-care reform. Its aim was to control costs by injecting more competition into the system, and to overhaul financing by introducing a central health fund. This is not a bad idea: such a fund could lead to a shift from contributions linked to pay, which drive up labour costs (and unemployment).

Yet the fund has turned into a monster, whose only purpose is to bridge the policy gap between the parties. The SPD wants contributions to stay linked to pay. The CDU wants to decouple them by introducing a flat-rate premium. The compromise is a fund fed largely by wage-based contributions, but with the option of a flat-rate fee on top. But on October 4th the coalition reached tentative agreement to postpone the new fund until January 2009—which may mean it never sees the light of day.

Other reforms could end up equally convoluted. The SPD wants a minimum wage; the CDU prefers in-work benefits. On corporate tax, both parties agree that Germany must cut rates to around 29%, but they are quarrelling over how to make up the revenue shortfall. Even an anti-smoking law, banning smoking in bars and restaurants, seems to be beyond the scope of coalition agreement.

It would be unfair to say that the government has done nothing. It points to federalism reform, to the decision to raise the retirement age to 67 and to big cuts in subsidies, which have helped to push the budget deficit below 3% of GDP. Last week parliament approved a new benefit to encourage families in which both parents work to have more children.

Nor are the coalition's failures all Ms Merkel's fault. They reflect three deeper problems. One is the inevitable tension within any grand coalition of left and right. A second is that, despite having a two-thirds majority in parliament, the grand coalition has been unable to circumvent powerful interest groups. Despite the overhaul of the federal system, state premiers still have substantial veto power. Indeed, they have even more say than under Mr Schröder; most are CDU heavyweights who influence coalition decision-making before reforms reach the upper-house Bundesrat, where states are represented.

The premiers are best seen as the country's most powerful lobbyists. On the health fund, it is the richer states such as Bavaria that are balking. Because of the way the fund's cash is distributed, richer states will subsidise poorer ones. Some CDU premiers are also manoeuvring to increase their chances of succeeding Ms Merkel. Were the health fund idea to fail, it might not make Ms Merkel a lame duck. But it would have a similar effect to the failure of Bill Clinton's health-care reform early in his presidency.

The third factor is that the two big parties continue to bleed support. In last month's state elections in Berlin and Mecklenburg-West Pomerania, the CDU and SPD between them secured the backing of only a third of those entitled to vote, a record low. This loss of support is sapping both parties' will to make sensible compromises. The SPD wants to sharpen its own profile and make the CDU the fall guy. The atmosphere within the government is increasingly frosty.

None of this means that the grand coalition will break up soon. Any other coalition is unlikely at this point, although there has been some speculation of a new one embracing the CDU, the Free Democrats and the Greens. A snap election might make such a grouping more likely, but engineering this is constitutionally awkward, and there is a risk that it would simply reproduce last year's result. It is equally improbable that the CDU premiers will club together to oust Ms Merkel.

It is more likely that the grand coalition will muddle through. Some events may even be on its side. Given the economic revival, next year's planned increase in VAT by three points to 19% may not slow growth as much as some economists feared. And in the first half of 2007 Germany's twin presidencies of the European Union and the G8 rich-country club will again let Ms Merkel cut a dash on the international stage. But unless her government discovers a new reforming zeal at home, it risks going down in history as a disappointment—even more so than the previous grand coalition in 1966-69.

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About sponsorship

The Austrian election

Another grand coalition?

Oct 5th 2006 | VIENNA
From The Economist print edition

Austria seems poised to follow Germany's example

AP

Gusenbauer triumphant

MOST Austrians seem fond of consensus politics. Their wish should now come true, as a coalition between the centre-right and centre-left, which have jointly run the country for most of its post-1945 history, is likely to return to power after the election on October 1st.

Surprising the pundits, voters punished the chancellor, Wolfgang Schüssel, for ruling from the right for six years. His People's Party shed eight points, to only 34%, less than the Social Democratic Party, which held broadly steady at 36%. The Social Democratic leader, Alfred Gusenbauer, had attacked Mr Schüssel's "cold-hearted" policies and promised more warmth and social spending.

Yet Mr Schüssel's real undoing was the revival of the far right. In 2000 he triggered world protests by deserting the coalition with the Social Democrats and joining forces with Jörg Haider's xenophobic Freedom Party, which had raised its vote to a spectacular 27%. At first Mr Schüssel's gamble paid off. The Freedom Party was racked by strife, saw its popular support collapse and split when Mr Haider formed a new group that remained part of Mr Schüssel's government. But last week Mr Haider's Alliance for Austria's Future got barely over 4%, whereas the Freedom Party, running on an anti-Islamic and anti-immigration platform, got 11%. Together, they robbed the People's Party of the votes it needed to stay in first place.

The far right's success limits the options for a future government. A coalition with the Freedom Party is unacceptable to Mr Schüssel. One between the Social Democrats and the Greens would fall just short of a majority. That leaves only a grand coalition between the Social Democrats and the People's Party, with Mr Gusenbauer as chancellor and Mr Schüssel retiring.

Mr Gusenbauer might slow privatisation and boost education spending. He wants to scrap the purchase of Eurofighter jets. But he will not interfere with Austria's flexible labour market or its recent corporate-tax cut. The Social Democrats favour tough immigration controls and are as wary of Turkey's European aspirations as the People's Party.

Unlike their German counterparts, the big parties in Austria have often worked together on reforms. They may shake up the federal structure, in which nine small provinces all have governments and parliaments. Yet the big beneficiary of a grand coalition could be the far right, which can appeal to unease over immigration and globalisation, plus the whiff of corruption that often swirls round broad-based governments. Austrians may like political cosiness, but it can be too much of a good thing.

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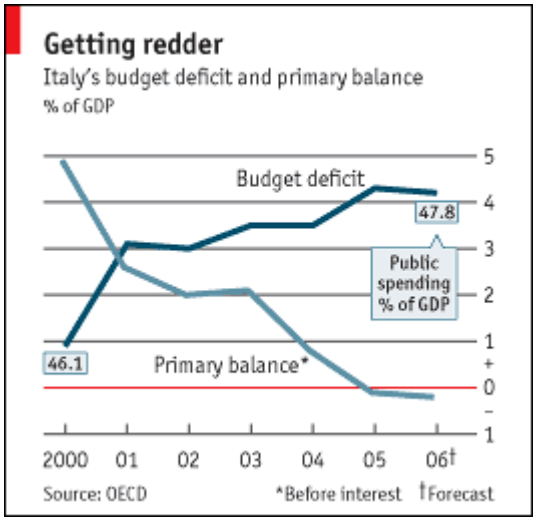
Italy's budget

Smoke and mirrors

Oct 5th 2006 | ROME
From The Economist print edition

Another year. Another Italian budget. Another ruse



THOSE who hoped that Romano Prodi's centre-left government would end the three-card-trick techniques of public accounting so dear to his centre-right predecessor, Silvio Berlusconi, must have been disappointed by its first budget. It does not rely on one-off measures to rein in the deficit. But it has another pernicious dodge.

One of the few liberal reforms passed by Mr Berlusconi's government gave employees a chance to invest in pension funds the contributions that they have to make to severance-pay funds, which were until now held by their employers. But surveys suggest that few will switch when the law takes effect next January.

The draft 2007 budget unveiled by Mr Prodi's finance minister, Tommaso Padoa-Schioppa, includes a provision to transfer half the cash not handed to pension funds to the government. This may be defensible, since it trims a hidden subsidy to Italian business (in the form of cheap financing). What is inexcusable is that the budget treats the cash as revenue, not as a debt that will have to be repaid. The forecast inflow, €5.3 billion ($6.7 billion), makes up over a third of the amount that the government claims to be cutting from the deficit.

This is not the sort of thing you expect of a former board member of the European Central Bank. But it shows how far Mr Padoa-Schioppa has had to bend to placate demands by left-wing parties within the government. The budget includes a watered-down cut in payroll taxes. But it also raises income tax and makes few big reductions in public spending. There is a risk that the net effect will be to curb already low GDP growth.

The main political debate has been about the way the income-tax changes are being imposed. The budget increases the rate of income tax from 41% to 43% for those earning over €75,000 a year. A former centre-right minister called this an “unprecedented social massacre”. Mr Berlusconi invited the middle classes to take to the streets. Mr Prodi said it would ease the inequality of the “most unjust of the major European countries”; the finance minister claimed that 90% of taxpayers would be better off.

That looks optimistic, especially since most of the spending cuts must be enacted by local authorities that may raise other taxes to offset them. That is also one reason to question whether Mr Padoa-Schioppa will cut the deficit by as much as he claims. But there are others. His severance-pay wheeze could be disallowed by Brussels. He is also relying on measures to curb tax evasion that may or may not have the desired effect (in this case, to bring in over €7 billion in revenues).

The biggest danger, though, is that the budget's edge will be blunted as it goes through parliament. Mr Padoa-Schioppa has delighted the trade unions and the left, but infuriated the increasingly restive centrist parties in the government, which fret that tax rises could lose them middle-class votes, particularly in the north. Following the defection of one senator, Mr Prodi's government has a majority in the upper house of just one seat. It is thus acutely vulnerable to demands from either end of its broad political spectrum.

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France's presidency

Runners and riders

Oct 5th 2006 | PARIS
From The Economist print edition

Ségolène Royal is the firm favourite to be the Socialists' presidential candidate

IN OPPOSITION, Britain's Conservative Party went through two election defeats and three failed leaders before plumping for one (David Cameron) who looks electable. Will the French Socialists be faster learners? This week they came a step closer to picking the only candidate (Ségolène Royal) who polls say can beat the front-runner on the right, Nicolas Sarkozy.

Three Socialists are contesting the nomination for next spring's presidential election. Against Ms Royal are Laurent Fabius, a former prime minister who espouses a hard-left anti-liberal creed, and Dominique Strauss-Kahn, a moderate ex-finance minister. They have six weeks to campaign before 212,000 party members vote on November 16th (if necessary, a second round will be held a week later).

Ms Royal is the overwhelming favourite. She has conquered public opinion: she tops the list of left-leaning politicians, according to TNS-Sofres, with a 59% popularity rating. She has won over Socialist voters: 49% would choose her, says Ifop, against 14% for Mr Strauss-Kahn and only 6% for Mr Fabius. Within the party, she is the favourite of the federation leaders who traditionally guide members' votes: she has the backing of 48 out of 83 who have expressed a preference, according to *Le Monde*. Many of the new party members who joined online are behind her too.

Ms Royal has already seen off three other would-be candidates. Last week Lionel Jospin, a former prime minister, quit the race. This week Jack Lang, a popular ex-culture minister, withdrew. And François Hollande, the party leader (and Ms Royal's partner), chose not to run, deferring to her greater popularity and his inability to rally support as a compromise choice.

Less than a year ago, Ms Royal's candidacy was dismissed by Socialist grandees as preposterous. She had no experience, they sneered, even though she has served as education, family and environment minister. She had no credibility, they scoffed, although she is the elected president of Poitou-Charentes, and the only female regional boss. When Alain Duhamel, a commentator, published a book in January entitled “The Pretenders 2007”, he included 15 aspirants—but not Ms Royal.

How has she pulled it off? Rather like Mr Cameron. The British Tory leader blurs political boundaries by hugging trees and denouncing health cuts; Ms Royal does the same by calling for young criminals to be taken in hand by the army. Like Mr Cameron, the snappily dressed Ms Royal dwells little on specifics and a lot on style. She has set up an interactive website, urging voters to help draw up ideas, as part of her campaign for a “participatory democracy”.

Above all, like Mr Cameron, the 53-year-old Ms Royal embodies (relative) youth, modernity and a new generation—and all without saying a word. As a vexed adviser to Mr Sarkozy puts it, “she is the message”: an outspoken, working mother of four, who has defied the macho culture of her party. In reality she has spent decades in politics; yet, next to rows of greying men in suits, she seems a breath of fresh air. “This makes her a particularly tricky opponent to attack,” he adds.

Mr Hollande promises to remain neutral. But he could not resist saying this week that “one candidacy has unquestionably established itself”. The contest may be bitter. This week, one of Ms Royal's brothers said that another, Gérard, a former spy, had planted the bomb that sank a Greenpeace ship in 1985. The timing was curious. But, like so many attempts to destabilise Ms Royal, it may end up boosting not discrediting her.

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Georgia and Russia

The mouse that roared

Oct 5th 2006 | MOSCOW
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Georgia nips its northern neighbour, and gets a clout in return

SPY scandals are usually gentlemanly affairs that end in discreet expulsions. But the latest Russian-Georgian row has erupted openly. It began when the Georgians arrested four Russian officers, accusing them of belonging to a military-intelligence unit and recruiting Georgians to a spy ring. President Vladimir Putin, himself a former KGB officer, denounced “an act of state terrorism with hostage-taking” and later talked of “blackmail”. He even accused Georgia of emulating Beria, Stalin's secret-police chief (both Beria and Stalin were Georgian).

Russia has severed all air, sea and land links to Georgia, and is to end postal services and money transfers. Each act was presented as a bureaucratic response to Georgian misbehaviour—late payments, unsafe practices and so on—but the blockade, coming after Georgia released the captured “spies” and after bans on Georgian wine and mineral water for alleged impurities, is looking like economic war. Georgia may now block Russian entry into the World Trade Organisation.

The Georgians are miffed over Russia's broader meddling, notably its support for separatists in the enclaves of Abkhazia and South Ossetia. “The message of Georgia to our great neighbour Russia is: enough is enough,” said Georgia's president, Mikhail Saakashvili. “We can't be treated as some second-rate backyard to some kind of re-emerging empire.”

For their part, the Russians suspect that the whole affair has been staged to raise Georgia's hopes of joining NATO. “They are clearly trying to pinch Russia where it hurts most, to provoke us,” said Mr Putin, who talked darkly of Georgia's “foreign sponsors”. The foreign minister, Sergei Lavrov, linked the arrests directly to NATO's agreement to start an “intensified dialogue” on Georgia's entry. And Sergei Ivanov, the defence minister and a possible successor to Mr Putin in 2008, accused unidentified NATO countries of illegally supplying weapons to Georgia.

Mr Saakashvili knows that his country can never join NATO, or claim full sovereignty, if it does not resolve the stand-offs with Abkhazia and South Ossetia. But this will be impossible so long as Russia backs the separatists. The temptation for him may be to provoke Russia even more, counting on Western support. Russia-baiting has made his party popular ahead of this weekend's local elections. But he needs to be cautious. A military assault on Abkhazia or South Ossetia would be ruinous, since Russia has issued passports to most people in the provinces and promises to protect “its” citizens. Moscow may also formally recognise the two regions' independence if Western governments give Kosovo independence from Serbia.

Besides, Mr Saakashvili has a plateful of domestic problems that can only get worse under the Russian embargo. Just last month Georgia claimed to have crushed a coup plot by a Russian-backed fugitive politician. More prosaic forms of pressure are available—such as last winter's mysterious explosions inside Russia that cut off gas and electricity supplies to Georgia. In a new cold war the Georgians could be in for a truly chilly winter.

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The Balkans

Troubling times

Oct 5th 2006 | SARAJEVO
From The Economist print edition

The future of both Kosovo and Bosnia gets murkier

THE Balkan endgame is starting to look messy. Expectations that Kosovo would be independent by early next year have just suffered a blow. Over 1.8m of the Serbian province's 2m people are ethnic Albanians who will settle for nothing less than independence. Yet the UN talks on Kosovo under Martti Ahtisaari, a former Finnish president, have got nowhere. Two weeks ago Mr Ahtisaari was given the go-ahead to draft his own plan for Kosovo's future. On September 22nd the UN Security Council said it hoped that the talks would finish by the end of the year.

Mr Ahtisaari, who is likely to propose some form of independence, was expected to present his plan later this month. But on September 30th the Serbian parliament adopted a new constitution that declares Kosovo to be an inalienable part of Serbia. This was a shrewd delaying tactic on the part of Vojislav Kostunica, the Serbian prime minister. The constitution must be ratified in a referendum at the end of October, and it will be followed by an election. Mr Ahtisaari can hardly put forward his plan before then, as the voters might react by switching in droves to the extreme nationalist Radical Party. That could destabilise the whole region.

Diplomats dealing with Kosovo prefer Serbia to have its election first, in the hope that democratic forces will win and then come round to accepting Kosovo's independence. But the election could be delayed. And if Kosovo's Albanians then start fretting that Serbia is successfully outmanoeuvring them, there is a risk that extremists among them will return to violence, which would not do their cause any good.

Voters in Bosnia also caused an upset on October 1st. A majority chose to put Bosnia's wartime foreign minister, Haris Silajdzic, into the Bosniak (Muslim) presidential seat in Sarajevo, turning out Sulejman Tihic, who was seen by Western diplomats as a moderate with whom they could work. Mr Silajdzic wants to scrap the Bosniak-Croat federation, as well as the Serbs' Republika Srpska. That upsets the Croats, who form a 14% minority, mostly in the south and west of the country. It also ruffles Milorad Dodik, who was easily re-elected as prime minister of Republika Srpska.

Many Bosnian Serbs see their republic as a legitimate legacy of the war. Mr Dodik has been making secessionist rumblings, claiming that, should Kosovo gain independence, his republic should be allowed to do so as well. The election of Mr Silajdzic will encourage more such talk, even though Bosnia's international overseers firmly reject the idea.

Christian Schwarz-Schilling, the German who now wields the power of international proconsul, has said that his office should be closed in mid-2007. It will be replaced by a lower-key European Union mission (and some of the 6,000 soldiers of the EU peacekeeping mission will stay). Although most parties in Bosnia say they want to get into the EU, one analyst, Senad Pecanin, fears that the necessary reforms could be blocked by the political radicalisation that is splitting the country into opposing camps. It does not help the moderates in Bosnia and Kosovo—nor in Serbia, for that matter—that the mood in Brussels and other EU capitals has recently turned against letting any more countries into their club.

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Charlemagne

The stultifying Brussels consensus

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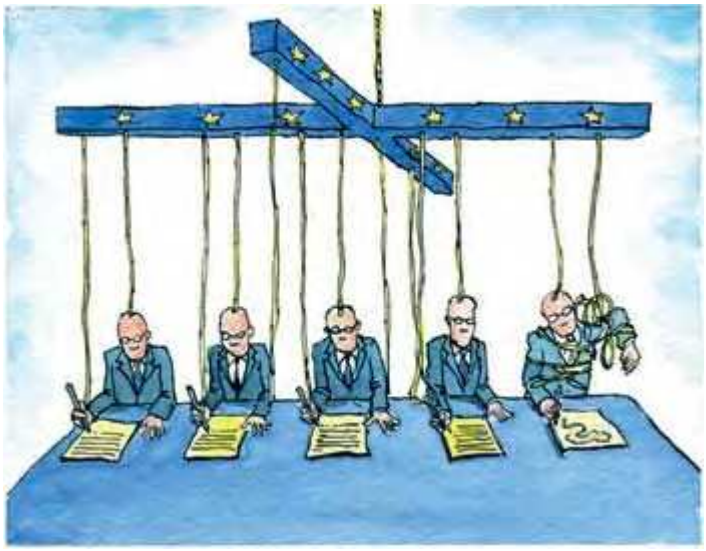
From The Economist print edition

What the fate of the Washington consensus reveals about the Brussels one



IN 1990 John Williamson, of the Washington-based Institute for International Economics, wrote an article pinning down like a butterfly the features of the “Washington consensus”. Mr Williamson meant by this a framework for policy in emerging countries that was accepted by almost all mainstream practitioners in the field, from the IMF and World Bank in Washington to governments and central banks in emerging markets. For the anti-globalisation crew, however, the phrase morphed into something else: a synonym for a “selfish, obscene and biased view of the economy” (to quote one of the more printable insults).

Now Mr Williamson is at it again. At Bruegel, a think-tank in Brussels, he recently sketched out the features of “a Brussels consensus”. The phrase, if it catches on, may share the fate of its American forebear. Indeed, it probably deserves to.

There is certainly a Brussels consensus: the phrase brings a shock of recognition. As Giles Merritt of Friends of Europe, a lobby group, points out, a European consensus existed before the Washington one. The building of the European Union was an elite project (“this blessed plot”, one Europhile British journalist called it), which is another way of referring to a consensus among European politicians and intellectuals. The Brussels consensus even shares features with its American counterpart. Originally, the Washington consensus had ten characteristics, falling under three broad headings: fiscal and monetary discipline, trade liberalisation, and privatisation-plus-deregulation. Almost all reappear in slightly different form across the pond.

The Brussels consensus codifies what in Washington were broad policy goals. The EU does not just recommend fiscal and monetary discipline; it runs a single currency and has rules to limit the size of participating countries' budget deficits (what an economist from the Catholic University in Leuven, Paul de Grauwe, calls its “numerology”). It has a formal bureaucracy devoted to breaking down business restrictions and promoting trade within the EU. And, like the Washington consensus, the Brussels one was more or less imposed on a bunch of middle-income countries, with the blessing of those countries' governments: Latin America for the Washington consensus, central and eastern Europe in the case of the Brussels one (and before that Spain, Greece and Portugal).

But the Brussels consensus has several features of its own. The Washington consensus did not concern

itself with social outcomes. The Brussels consensus does: article three of the ill-fated EU constitution talks of a “social-market economy”. Unlike the Washington consensus, which was never primarily political, the Brussels one is explicitly so: one article in the Treaty on European Union declares that it is founded on the principles of democracy and the rule of law. And central to the Brussels consensus is a particular view of the so-called European project, which might best be described as the belief that Europe is greater than the sum of its parts. There is no equivalent in the Washington consensus.

These differences mean that the Brussels consensus cannot quite play the role that Mr Williamson claimed for the Washington one. A proper consensus draws a clear line between policies that are universally accepted (and hence removed from political debate) and those on which partisan dispute may continue. The Washington consensus decreed that monetary and fiscal discipline were accepted (even by, say, the government of Luiz Inácio Lula da Silva in Brazil). But that left room for argument over such matters as income distribution, public or private provision of government services, and fixed versus floating exchange rates.

In practice, moreover, reaction to the label of Washington consensus showed that some of its core features (notably the virtues of globalisation) were not really accepted as consensual. And that is even truer of the Brussels consensus.

Not so accepted acquis

In describing European economies as “social market”, the failed constitution implies that the distribution of wealth and income is a consensual matter, and that partisan political debate about it should be limited. Yet as Sweden, a founding father of the social market, showed in its recent election, debate on social outcomes is the meat and drink of politics in most European countries. Enlargement of the club has also become part of the Brussels consensus: it flows directly from the belief that European countries that meet the conditions of membership should join. Yet whatever one thinks of enlargement (Charlemagne is a strong supporter), nobody can claim that a consensus exists in its favour.

For a consensus to hold, moreover, its basic elements must be understood by all—otherwise there will be no clear line between what is accepted and what is debatable. Few things are more basic than spelling out the powers that pertain to the centre and those that remain with nation-states. But in fact this is a shifting muddle. For years, criminal law and policing, for example, have been core competences of national governments. But the European Commission is now trying to grab power over these matters from the national level.

In short, the Brussels consensus blurs the line between things that are consensual and things that are not, and takes as consensual things that should properly be debated. It unduly depoliticises the political process.

The rejection of the draft constitution has done for the Brussels consensus what the collapse of Argentina, Thailand and Russia did for the Washington one: laid open the dangers of relying exclusively on elite opinion. A consensus closes off whole areas of political debate. What Europe needs is more debate, not less. The risk otherwise is that the Brussels consensus will go the way of its Washington cousin and become what it is beginning to seem anyway: a consensus, based on a few good ideas, that is accepted in Brussels, but nowhere else.

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School building

Who wants a new classroom?

Oct 5th 2006 | BRISTOL
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Rebuilding schools turns out to be a good way of forcing through changes to how they are run

Popperfoto

ASK pupils what they would like to see changed about their schools and they will come up with a surprisingly modest list. They want roofs that don't leak, chairs with four legs apiece, graffiti-free lavatories and no hidden spaces where bullies can lurk. The more daring will then start talking about the snooker rooms, cinemas and coffee bars you might have thought would be top of their wish lists.

Over the next 15 years visions both modest and ambitious will be realised as the government indulges in an orgy of wrecking and rebuilding. Under a programme known as “building schools for the future”, half of England's 3,500 state secondary schools are to be knocked down and replaced, and the rest remodelled and refurbished. Private companies will stump up half the cash with the other half coming from the public purse.

Builders and architects, together with companies specialising in building security, software and other services will bid for contracts to design, build and run small clusters of schools. If successful, they will have the exclusive rights to future contracts in the district. They will make money by charging for their services over the next 25 years, and will be paid according to complex formulae that specify everything from how often toilets must be cleaned to how many of a school's laptops may be out of service at any point.

This is just part of government spending on schools, but it is an influential part that is designed to speed other reforms. Last year Parliament approved plans to replace “bog-standard comprehensives” with “independent state schools”. At the time the bill was described as enabling rather than prescriptive. By linking cash to administrative changes, the building programme gives it concrete form.

Education's Trojan horse

The bidding process favours schemes in which outsiders, linked to schools via trusts, pledge to provide an “ethos” and fresh thinking (code for shaking up the educational establishment). Academies—state schools run by a private sponsor—will also be encouraged. Successful schools will be prodded to take over and run failing ones. Schools are expected to be open long hours, with breakfast clubs and after-school care.

Local authorities know that if they want new buildings, they must play along—and some schools are

desperately in need of renovation. First to face the bulldozer are some built after the second world war to serve housing estates that sprang up where bombs had fallen thickest. Bristol is about to demolish and rebuild four schools, among them Whitefield Fishponds Community School. The head teacher, Theresa Thorne, is excited by the designs for her new school. Recent expansion has left her managing ten scattered temporary buildings; the first thing that greets pupils in the morning is the back of the gym hall.

This jumble is to be replaced by a gracious pavilion ushering visitors onto a centrally-heated street, with clusters of classrooms on one hand and larger spaces on the other. The “strawberries”, as the architects, Wilkinson Eyre, have nicknamed the classroom clusters, have a workplace at one end, positioned so that a member of staff can keep pupils “safe but not guarded”. Blind spots will be eliminated to cut down on naughtiness. Desks will be arranged in a horseshoe to stop students from slacking in the back row.

The desire for surveillance crops up again in Bristol's IT plans. The technology is to be provided by Northgate Information Solutions, which currently issues most of Britain's traffic-infringement notices. Its “managed learning environment” will integrate many different educational programs. It will also allow parents to see what children are doing (by tracking attendance, homework and canteen purchases), teachers to see what students are doing, and bureaucrats to see what teachers and students are doing (by recording the cost of staff phone calls and truancy, for example).

By using private cash, the government hopes to get better schools built on time and within budget, ensure maintenance is carried out and offload risk. But according to a report by the Audit Commission, which monitors government spending, the few privately financed schools that have been built are shoddier than similar ones paid for by public-sector borrowing. Before they can get the go-ahead for rebuilding, local authorities must use methodology developed by the Treasury to show that private finance will prove better value than public borrowing. Yet an investigation by Andrew Coulson, a local government expert at Birmingham University, concluded that the methodology has a built-in bias towards the former.

Teachers' unions fear that mergers encouraged by the reforms will be used as a cover for redundancies. Long-term contracts may tie local authorities into paying for services that are no longer used, or, alternatively, paying too much for facilities that end up being used more than forecast. And there is always the risk that a consortium that finds its profits lower than expected will just pay the necessary penalties and walk away, leaving the taxpayer to pick up the bill.

Those who cannot remember the past

Architects have always nursed visions of what can be achieved in the right building. But it is unlikely that fancy accommodation will transform learning as dramatically as they (and the government) imagine. Rebuilding a crumbling edifice improves results, says Elaine Hall, an education researcher at Newcastle University who has studied past building programmes. But as long as classrooms are decent—not too dark, damp, noisy, airless, hot or cold—further frills seem to make little difference.

The post-war structures that now seem so flimsy were, in their day, cutting-edge architecture. Their big windows were meant to let in light rather than draughts. Flat roofs were designed to allow builders to stack modules on top of one another, rather than let in rain. That they were cheap and quick to build was seen as a virtue in more frugal days, and it meant they could be altered easily. But they were not used in the way their designers intended. Rank-and-file teachers were not keen on the avant-garde methods—open classrooms, pupil-directed learning—favoured by the leading pedagogues consulted by architects, and so just kept doing what they had always done. No money was set aside to carry out the adaptations that had been designed in so carefully.

Once again, a large-scale building spree risks duplicating mistakes all over the country. Mike Skilton, an architect who designs schools, believes partition walls will be the flat roofs of the future. “No one will take them down, and they are acoustically useless,” he says. Ms Hall nominates atriums: “I look at them and wonder how much square footage you could have got in classrooms instead.”

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The minimum wage

Danger zone

Oct 5th 2006
From The Economist print edition

It began moderately, but has risen too far, too fast and now threatens jobs

SO FIRMLY entrenched in the political economy has the minimum wage become that its latest increase, on October 1st, to £5.35 ($10.08) an hour, caused little stir. Yet the introduction of a national pay floor in 1999 was one of New Labour's most radical economic policies. Although minimum wage rates had previously covered a few industries, this was the first time that a general rate had been set.

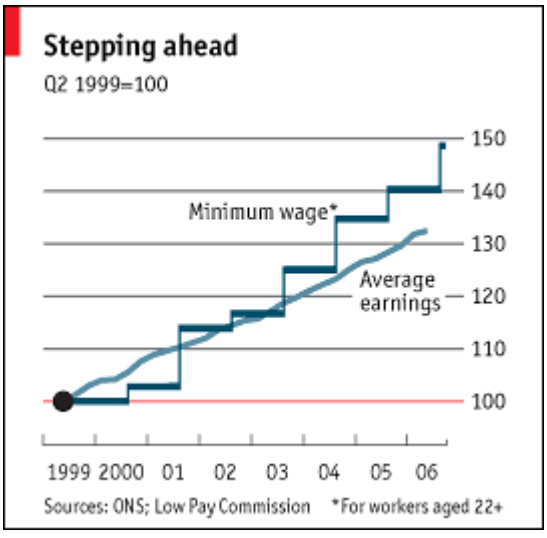
During the 1997 election campaign the Conservatives said that the policy would destroy jobs. Some economists calculated that hundreds of thousands of people might be put out of work. These dire warnings proved way off the mark after the national minimum wage came into force seven years ago. The feared job losses did not materialise.

However, that benign outcome had much to do with the cautious approach the government, advised by the Low Pay Commission, at first adopted. In April 1999 the main rate—for workers aged 22 or over—was set quite low, at £3.60 an hour. Eighteen months later, the rate edged up to £3.70. At this level it was worth only 36% of average hourly earnings for all employees. Furthermore, workers aged 18 to 21 had a separate, lower rate, which began at £3 in 1999 and was raised to £3.20 in October 2000.

The modest starting point for the minimum wage meant that it affected relatively few workers. The commission initially thought that it would raise the pay of around 2m workers but in practice only about a million gained. This limited any possible loss of jobs.

After the initial period of caution, however, the government got bolder. This month's increase pushed the main rate up by 6%, comfortably ahead of average earnings which went up by 4.4% in the past year. Since 1999 the minimum wage has risen by 49%, outstripping average earnings which increased by 32% in the past seven years (see chart). As a result, it is now worth 41% of average hourly earnings.

This trajectory contrasts sharply with what has happened in America. The federal minimum wage has stayed at $5.15 since September 1997. At this level, it is worth 27% of average hourly wages for all employees other than those working in agriculture or for the federal government—far stingier than Britain's rate.



The commission accepts that the period when the minimum wage rose faster than average earnings is over. The worry, however, is that it has already risen to a level that will hurt employment. The Confederation of British Industry said on September 24th that businesses in several parts of the economy, such as retailing, were struggling to cope with the minimum wage. A few days later the British Chambers of Commerce (BCC) added that the latest increase would have “serious implications” for firms. David Kern, who advises the BCC, says: “There is now a distinct risk that the minimum wage will have an adverse effect on jobs.”

Whether employment will necessarily take a big knock is uncertain. Mainstream economic theory suggests that a minimum wage set too high will cost jobs. However, the evidence from other countries has been quite mixed. Some studies find no impact on employment whereas others find the jobs do indeed disappear, especially among young people.

In a recent appraisal of employment policies in the world's developed economies, the OECD said that “a moderate minimum wage generally is not a problem”. Britain's experience in the first few years of the policy bears out that judgment. But more recent increases have pushed the rate up to a level where it may inflict damage.

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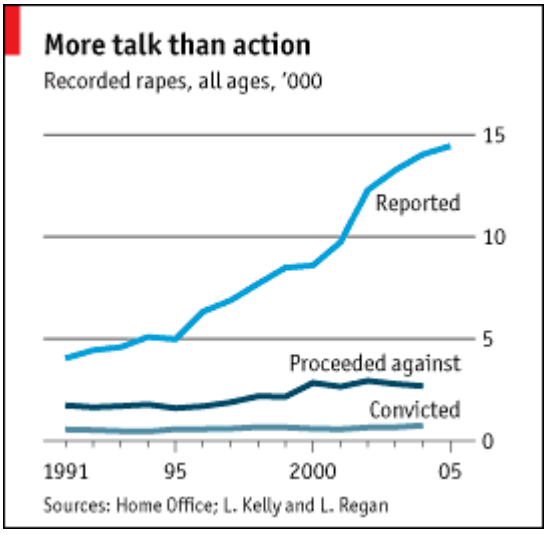
Prosecuting rape

Getting away with it

Oct 5th 2006
From The Economist print edition

The criminal-justice system fails rape victims. Reforming it won't be easy



MEN accused of rape in England and Wales should count themselves lucky: only one in 19 will be convicted of the crime. Their odds are still better in some places. In Gloucestershire just one of 116 reports of rape led to conviction last year. Liz Kelly, an academic with the government's ear, dubs the system a “culture of impunity”. The Home Office has asked for opinions on why so few reported rapes lead to a conviction, with a view to changing the law. But, so far, the consultation has revealed uncertainty and rancour over what is wrong at the moment.

The police now record more rapes than ever. That is probably a good sign because it suggests they are more trusted (the numbers have also been bumped up slightly by changes in how cases are counted). But it would be a better sign if convictions had kept pace with allegations. They have not. Between 1991 and 2004 the number of rapes recorded by the police rose by 247% (see chart). In the same period, prosecutions went up by 54% and convictions rose by just 34%. The conviction rate in England and Wales used to be about average. It is now one of the lowest in Europe.

One reason for the widening gap, police officers say, is that they now investigate trickier cases. They are more likely to pursue allegations about assaults in the home, directed against current or former partners. It is hard to convince prosecutors that such cases have any chance of success; and, even if the lawyers can be persuaded, juries often cannot. Jurymen, like most people, tend to think of rape as something done by men who lurk behind trees.

Campaigners disagree. They point out that many coppers lack proper training: a report by the Association of Chief Police Officers last year found that just ten out of 42 police forces in England and Wales had special sexual-assault investigation-teams. And researchers at London Metropolitan University say that police officers, even those trained to investigate sexual offences, almost certainly overestimate the proportion of claims that are false.

Betsy Stanko, an academic who has examined 700 case files in London, has found another reason why the police drop cases: kindness. Officers know that some kinds of victim stand little chance of being believed in court. They include people who had been drinking before the attack took place (one in three cases) and the mentally ill (one in five). In such cases, coppers often take what Ms Stanko terms “sympathetic withdrawal statements” and do not press the matter further.

If the police believe courts do not look kindly on many rape victims, they are right. Scant evidence, the difficulty of weighing contrasting accounts and the severity of the prison sentence (not to mention the dismal experience in jail for a convicted rapist) make convictions unlikely. Even after police “filtering”, fully 72% of rape prosecutions failed in 2004, although many defendants were found guilty of related crimes.

Ministers are now considering allowing rape victims to give recorded evidence to court—although they would still face cross-examination. Expert witnesses may be allowed to explain why traumatised victims do not necessarily go immediately to the police. Most controversially, ministers may review the definition of “capacity to consent”. At present, a drunk person may be regarded as capable of consenting to sex,

even if he or she does not remember doing so afterwards.

The Criminal Bar Association, which represents both prosecution and defence barristers, is sceptical. The lawyers believe jurors are quite capable of distinguishing the kind of drunkenness that enables consent (though it may be regretted afterwards) and a state of deeper inebriation, which makes consent meaningless. They point out, too, that if expert witnesses are allowed into courtrooms, defence lawyers will simply summon their own.

Nor is Ms Kelly convinced that legal reforms will make much difference. Since so few cases get as far as the courtroom, she believes, effort must be concentrated on changing the attitudes of the police and the public towards rape.

Ms Stanko is working on a new approach. Her analysis of London cases suggests there are four broad types of offender—the stupid, the psychotic, the opportunist and the predatory. Once offenders have been profiled, she believes it will become much clearer if they are targeting a particular group. Juries may feel more confident in convicting rapists if they can see a pattern in the kind of victim who gives evidence—women with mental health problems, say, or people who had been drinking in a club shortly before an attack. London's police will shortly consider whether to adopt such a method.

Rape is a distressingly common experience. Six years ago roughly one woman in 20 and one man in 100 told the British Crime Survey that they had been raped at some point since the age of 16. And, at the moment, victims' prospects are poor. Frequently disbelieved, disregarded and humiliated in court, they often feel they have been assaulted twice.

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High-tech Tories

Tory 2.0

Oct 5th 2006 | BOURNEMOUTH
From The Economist print edition

The Conservative Party grapples with technology

Reuters

ITS membership may be greyer than the other two parties' and its brand values fustier, but the Conservative Party has overtaken Labour and the Liberal Democrats in the technological sphere. Some of the party's innovations unveiled at its conference in Bournemouth this week should help to make it look more modern, and may even allow party leaders to get their views across unmodified either by Tory activists or by the press. But others look as if they will make a party that has a talent for insubordination even harder for its leaders to boss around.

David Cameron began the conference by introducing "Webcameron", an internet site where the curious can download video clips of the Conservative leader talking about politics while he potters about his house in west London. The clips are designed to look more like something that might be posted on YouTube, a video-sharing website, than the slick, supposedly informal chat between Tony Blair and Gordon Brown (directed by an Oscar-winner) that appeared on the Number 10 website before the last general election. In the clips, Mr Cameron talks about the importance of the environment and about cleaning up politics while wandering around his kitchen with a pan that recently contained porridge. He turns on the dishwasher with the practised flourish of a matador. His children demand his attention. He is, in case you had not noticed, a new kind of Conservative.

Each of the party's seven policy groups, most of which are due to report next spring, has its own website too. The hope is that they will attract people who might not show much interest in the Conservatives, and flatter them by making them think they are shaping the policy direction of the next government. Thus far the sites have not been thick with traffic. A large proportion of posts have elicited no comments, and their affiliation with the Conservative Party seems to have put off the non-aligned voters that the policy groups hoped the sites would attract.

Other Conservative forays into the internet are provoking a less docile response. A few months ago ConservativeHome, an unofficial party blog, obtained an early leak of the party's A-list of new, improved candidates and swiftly published it, stimulating caustic comment about some of them. This week the site released a survey of its users, who revealed themselves to be ambivalent about the direction in which Mr Cameron is taking the party and impatient for tax cuts.

The same rebellious spirit, magnified by technology, was on display inside the conference hall. Activists were issued with hand-held devices for sending text messages, some of which flashed up on the big screen above the stage. This did not go completely according to plan either. While Shami Chakrabarti of Liberty, a pressure group that spends its time attacking the government and the police for their draconian ways, attempted to impress on the conference the importance of ancient freedoms, a running commentary in pithy messages appeared above her head. "Thugs should be made to fear the police," read one. "What's wrong with a quick clip round the ear?" asked another. Perhaps Mr Cameron was thinking the same thing as he pondered how to cajole his party into sounding a bit nicer.

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Natural gas

Turning down the heat

Oct 5th 2006
From The Economist print edition

New capacity should bring winter gas prices down

MANY people believe that investing in the stock market is little better than gambling. Spare a thought, then, for the traders who have to cope with the wild swings of Britain's gas markets. Last winter and spring, spot prices twice spiked to record highs. In one two-day period prices rose threefold, to 180p per therm. Factories closed and National Grid, which runs Britain's gas network, warned that there might not be enough to go round. Seven months later, on October 4th, famine turned to feast as prices fell as low as 0.12p.

Sadly, such bounty will be short-lived. The extra gas is flowing from the newly-completed southern half of the Langeled pipeline, which connects Britain to the Norwegian Troll and Sleipner gas fields (see map). The glut is the result of capacity tests on the Troll field, according to Gassco, the firm that runs the pipeline, and the experiments will finish by the weekend.

Proof that the pipeline works will nonetheless be welcomed in British boardrooms, where memories of last winter's price spike have pushed energy prices to the forefront of bosses' minds. In addition to Langeled, another pipeline (this one from the Netherlands) is due to open later this year; an existing connection to Zeebrugge is being upgraded and a new liquefied natural gas terminal is opening at Teesside. In theory, all this extra import capacity should help offset declining North Sea production. Until recently, that had insulated Britain from the sort of winter energy worries that other countries endure.

But pipes may not be enough. After all, the problem last winter was not a shortage of capacity but a lack of gas to fill it. The Zeebrugge-Bacton pipeline, for example, was half full for much of the winter, despite high prices. The reason, says Andrew Morris of Pyory, an energy consultancy, is that European firms get much of their gas through long-term contracts. That leaves Britain's liberalised market, which makes much less use of such agreements, to pick up the remainder. “Langeled will smooth things over”, he says. “But a lot of Norwegian gas is contracted to go to Europe, so the pipe will not be full.” Much will therefore depend on the weather: a mild winter will allow Britain to pick up spare gas cheaply, whereas a cold spell could push prices up sharply.

So far the weathermen are hedging their bets, with Met Office scryers saying that it is unclear whether the winter will be warmer or colder than average. Energy experts are cautiously optimistic: Ofgem, the

energy regulator, has forecast that gas will be more plentiful. Wood Mackenzie, a Scottish consultancy, reckons on a price fall of around 8% compared with last winter.

In the long run, ministers hope that liberalising European gas markets will allow Britain to make better use of its shiny new import facilities. Here, the signs are clearer: Neelie Kroes, the commissioner responsible, talks tough, and her department is conducting anti-trust investigations into several European firms. Change is coming from below, too. “Trading is starting to take off in the Netherlands and in Germany,” says Mr Morris. “But it could take three or four years to mature.”

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TV quizzes

Minted

Oct 5th 2006
From The Economist print edition

ITV and Channel 4 have finally worked out how to make money

LATE one night earlier this year, Bill Mundy, a miniature-portrait painter from Henley-on-Thames, was in bed watching a quiz programme on ITV called “The Mint”, which exhorts viewers to call in answers to puzzles to win tens of thousands of pounds. He called repeatedly, adding £20 to his telephone bill, but didn't get through to the programme. “I realised afterwards that I was just one of the hundreds of suckers who'd not even got to first base,” complains Mr Mundy.

ITV

Just getting through is like winning the lottery

Television executives, who consider British telly to be the world's finest, are astonished that ITV, the country's largest commercial network, would risk its reputation with tacky call-in quiz shows that many reckon are unfair and exploitative. Thousands of people are paying for premium-rate phone calls and have little idea of the odds they are up against. After receiving hundreds of complaints, the communications regulator is about to look into whether to remove the programmes from ITV1 and ITV2 by reclassifying them as adverts for phone lines. The Gambling Commission is examining whether they are in fact lotteries, which would mean a fifth of profits would have to go to charity.

For now, ITV cannot resist the easy money. As Britain's television market has evolved and fragmented to offer hundreds of channels on several platforms, its share of the audience is shrinking and advertising revenues are plummeting. ITV Play, which airs “The Mint” and other phone-in quiz shows on a digital channel as well as on ITV1 and ITV2, has turned out to be surprisingly profitable. Telephone companies give ITV a big slice of the cash that comes in from viewers' premium-rate phone calls. These cost 75p from a BT landline, more from a mobile phone. In the first half of the year, ITV Play brought in some £30m of revenues—a fraction of the sums it makes from advertising, but enough to excite the City.

Channel 4, a government-owned outfit whose stated mission is to fulfil a range of worthy purposes with “public-service” programming, is also coining it from call-in quiz shows. Last year it started Quiz Call, a digital channel. Channel 4, too, worries about shrinking audiences. On the other hand, BSkyB, a TV company with no public-service duties, decided against offering call-in quiz shows last year because it thought them unfair to viewers.

One of the reasons there has been such a fuss about the quiz shows is that they appeal to the poor. So far this year, according to a company that measures television audiences, more than half of the viewers for ITV Play belong to social category “E”, meaning they are pensioners or casual workers. Some 40% are 65 or over and 70% are women. The audience for “The Mint” contains lots of young mothers, shift

workers, students and older people who don't sleep well at night, says Stephen Leahy, chairman of Ludus Entertainment, which co-produced it.

Another problem is that the questions often have no one correct answer or are tricky. This week, for instance, “The Mint” asked viewers for a word that would complete four other words. There were simple solutions, but the answer was “fyke”—a type of fishing net. The prize went unclaimed. According to a former employee, the programme at first had higher standards, but then ITV began prolonging the quizzes to bring in more calls, devising trickier questions and giving out less money (it has paid out £6m in six months).

Jeff Henry, ITV's head of consumer business, shows little embarrassment about the broadcaster's new direction. ITV chastises people if they make a large number of calls, he pointed out recently—what it calls a “headmaster's voice” comes on to warn them when they've made 20, 40, 80 and 100 calls, and at 150 the programme rejects the caller (who must nonetheless pay for his calls). And ITV says that its aim is not to encourage people to run up huge phone bills. It wants to profit from lots of people playing a little and often. Of the people who contact its shows, it points out, 86% ring fewer than ten times a week. So, at most, those who don't win are wasting about three times the cost of a television licence for the year.

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Bagehot

A hard road ahead for Mr Nice Guy

Oct 5th 2006
From The Economist print edition

David Cameron is serious about wanting to change his party, but electoral success is still not guaranteed

DAVID CAMERON may not yet have much in the way of policies. But, as the young Tory leader brought the curtain down on this year's political conference season with a speech that extolled civil partnerships between gay couples and praised the NHS as one of the 20th century's greatest achievements, at least one thing has become clearer. He is no less serious about reshaping his party than were Tony Blair and Gordon Brown about changing theirs in the early 1990s. And in some ways, what Mr Cameron is trying to do is both riskier and more difficult.

Before the conference opened, a great deal was made of the refusal of Mr Cameron and the shadow chancellor, George Osborne, to bow to pressure from traditionalists to promise tax cuts. In truth, there was always something slightly synthetic about this “row”. As Mr Osborne said in an impressive speech, there is no such thing as a tax-cutting shadow chancellor. A decade ago, Mr Brown's commitment to eye-wateringly tight Tory spending targets was accepted by his party in the (more than justified) belief that a Labour government would eventually pour more money into the public sector than a Conservative one. So too most Tory supporters know that in the long run taxes will be lower under Messrs Cameron and Osborne than under a government led by Mr Brown.

But to convince the voters that change is real, it is essential for a few diehards to play their roles. So it helped that the main dissident voices were those of Lord Tebbit, the ageing Mr Nasty of high Thatcherism; Edward Leigh, the leader of a gaggle of the most reactionary Tory MPs; and the otherworldly John Redwood. As a member of the shadow cabinet put it: “If one was being unkind, one might describe them as useful idiots.”

Of rather more significance was the ruthlessness with which Mr Cameron and his team placed their stamp on the conference itself. From the rather weird sylvan backdrop to the endless stream of studiedly unTory celebrity guest speakers, this was a Conservative conference quite unlike any other in the party's long history.

In the debate on crime and disorder, the main speakers, apart from a slightly scary policeman, were Camila Batmanghelidjh, the exotically-clad founder of the yob-embracing Kids Co, and Shami Chakrabarti, the feisty head of Liberty. In a session on the economy, the conference listened intently to a

speech by Will Hutton, the chief executive of the Work Foundation and the author of “The State We're In”, a seminal New Labour tract which had hardly a good word to say about the achievements of Thatcherism. The subtext could not have been more obvious. Mr Cameron not only wants to replicate the “big tent” politics of early Blairism, he is also well aware that there are very few Tories who he can trust to be on-message.

To an even greater extent than the New Labour “project”, this is an attempt to transform a party by a relatively tiny vanguard. By the time Mr Blair became Labour's leader in 1994, a good deal of the groundwork had already been done. That Mr Blair was overwhelmingly his party's choice (and would have been even if Mr Brown had stood against him) was itself proof of how the party had changed. It might not have known how far to the right Mr Blair would take it, but it had little doubt about the direction of travel.

The same was not true of the Conservative Party when it chose Mr Cameron ten months ago. It did so mainly because it liked his freshness and optimism. It also saw a sprinkling of the stardust that has been visible on no Tory leader since Margaret Thatcher. But according to polling carried out by Populus, Tory supporters still don't see him as being well to the left of his party. When Mr Cameron talks of dragging his party on to the centre ground of British politics, either they don't really believe it or they don't yet realise what it will mean.

Another difference between what Mr Cameron is attempting and what Mr Blair accomplished is that by the time Mr Blair became leader, the tide had already turned in Labour's direction. With powerful electoral momentum behind him, Mr Blair could challenge his party with relative impunity.

The electoral prospects for the Tories are far less certain than they were for Labour in the mid-1990s. The government they are up against is not divided over great issues of principle, nor has it recently presided over a deep and painful recession. And for all that Mr Cameron appears to be impatient to see Mr Brown installed as prime minister, he knows him to be a formidable adversary, very different from the shambling political zombie poor John Major had become. Mr Cameron may be largely responsible for the Tories' best poll ratings since 1992, but there are mutterings in the ranks that the party should be much more than four or five points ahead of an unpopular government in its tenth year.

Fear and loathing

Mr Cameron faces a further difficulty. All his efforts are aimed at convincing voters that the harsh, selfish, repulsive Tories are now the kindly, caring, decent Tories. But Mr Blair, with his unrivalled knack for sniffing out the mood of the electorate, believes that much as people want an efficient health service and good schools, they are more than ever fearful of terrorism, crime and mass immigration. He is also convinced that the Tories have already put themselves on the wrong side of the argument by trying to water down anti-terrorism legislation.

Both Mr Blair's conceivable successors, Mr Brown and John Reid, the pugnacious home secretary, will have no compunction about outflanking the Tories on the authoritarian right if they seem to be putting civil liberties before national security. Mr Cameron may succeed in making his party nice just as the voters are turning nasty.

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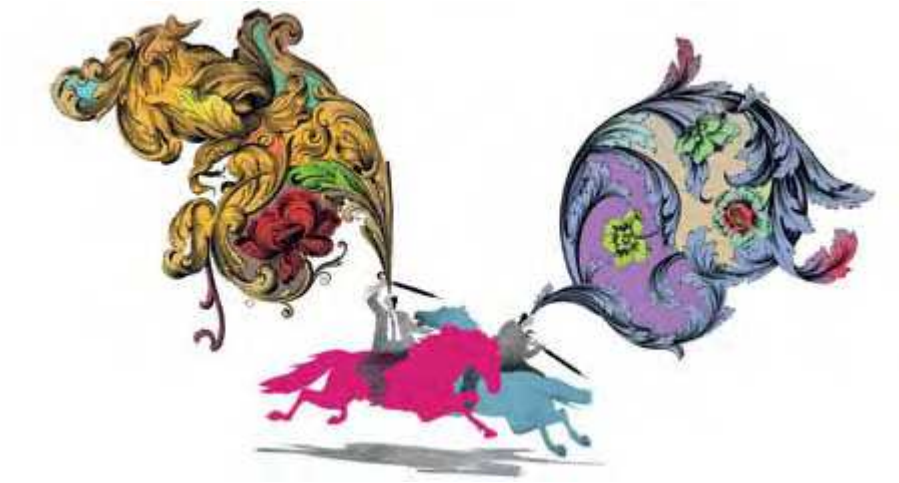
The battle for brainpower

Oct 5th 2006
From The Economist print edition



Talent has become the world's most sought-after commodity, says Adrian Wooldridge. The shortage is causing serious problems

IN A speech at Harvard University in 1943 Winston Churchill observed that "the empires of the future will be empires of the mind." He might have added that the battles of the future will be battles for talent. To be sure, the old battles for natural resources are still with us. But they are being supplemented by new ones for talent—not just among companies (which are competing for "human resources") but also among countries (which fret about the "balance of brains" as well as the "balance of power").

The war for talent is at its fiercest in high-tech industries. The arrival of an aggressive new superpower—Google—has made it bloodier still. The company has assembled a formidable hiring machine to help it find the people it needs. It has also experimented with clever new recruiting tools, such as billboards featuring complicated mathematical problems. Other tech giants have responded by supercharging their own talent machines (Yahoo! has hired a constellation of academic stars) and suing people who suddenly leave.

But a large and growing number of businesses outside the tech industry—from consulting to hedge funds—also run on brainpower. When the Corporate Executive Board (CEB), a provider of business research and executive education based in Washington, DC, recently conducted an international poll of senior human-resources managers, three-quarters of them said that "attracting and retaining" talent was their number one priority. Some 62% worried about company-wide talent shortages (see chart 1). The CEB also surveyed some 4,000 hiring managers in more than 30 companies, and was told that the average quality of candidates had declined by 10% since 2004 and the average time to fill a vacancy had increased from 37 days to 51 days. More than one-third of the managers said that they had hired below-average candidates "just to fill a position quickly". The CEB found, too, that about one in three employees had recently been approached by another firm hoping to lure them away.

Can't get enough of it

All this brings back memories of the dotcom boom in the late 1990s, when management consultants were writing books such as “The War for Talent” (by Ed Michaels, Helen Handfield-Jones and Beth Axelrod of McKinsey), telling companies that they must move heaven and earth to recruit and promote the best talent. No sooner had the bubble burst than many former masters of the universe were begging for work.

Indeed, companies do not even know how to define “talent”, let alone how to manage it. Some use it to mean people like Aldous Huxley's alphas in “Brave New World”—those at the top of the bell curve. Others employ it as a synonym for the entire workforce, a definition so broad as to be meaningless.

Nor does stocking up on talent seem to protect companies from getting it spectacularly wrong. Enron did everything that Mr Michaels and his colleagues recommended (indeed, McKinsey was both a consultant and a cheerleader for the Houston conglomerate). It recruited the best and the brightest, hiring up to 250 MBAs a year at the height of its fame. It applied a “rank-and-yank” system of evaluation, showering the alphas with gold and sacking the gammas. And it promoted talent much faster than experience. Another corporate disaster, Long-Term Capital Management, was even more talent-heavy than Enron, boasting not only MBAs but Nobel prizewinners among its staff. But despite all this talent, the companies still succumbed to greed and mismanagement.

The coming shortage

Clearly there is more to good management than hiring the best and the brightest. Among other things, it requires rewarding experience as well as talent, and applying strong ethical codes and internal controls. Indeed, talent-intensive businesses have a particular interest in maintaining high ethical standards. Whereas in manufacturing industries a decline in such standards is often slow, in talent-intensive ones it can be terrifyingly sudden, as Arthur Andersen and Enron found to their cost.

All the same, structural changes are making talent ever more important. The deepest such change is the rise of intangible but talent-intensive assets. Baruch Lev, a professor of accounting at New York University, argues that “intangible assets”—ranging from a skilled workforce to patents to know-how—account for more than half of the market capitalisation of America's public companies. Accenture, a management consultancy, calculates that intangible assets have shot up from 20% of the value of companies in the S&P 500 in 1980 to around 70% today.

McKinsey makes a similar point in a different way. The consultancy has divided American jobs into three categories: “transformational” (extracting raw materials or converting them into finished goods), “transactional” (interactions that can easily be scripted or automated) and “tacit” (complex interactions requiring a high level of judgment). The company argues that over the past six years the number of American jobs that emphasise “tacit interactions” has grown two and a half times as fast as the number of transactional jobs and three times as fast as employment in general. These jobs now make up some 40% of the American labour market and account for 70% of the jobs created since 1998. And the same sort of thing is bound to happen in developing countries as they get richer.

A second change is the ageing of the population. This will be most dramatic in Europe and Japan: by 2025 the number of people aged 15-64 is projected to fall by 7% in Germany, 9% in Italy and 14% in Japan. But it will also make a difference to China, thanks to its one-child policy. And even in America, where the effect will be less marked, the retirement of the baby-boomers (which has just started) means that companies will lose large numbers of experienced workers over a short period. RHR International, a consultancy, claims that America's 500 biggest companies will lose half their senior managers in the next five years or so, when the next generation of potential leaders has already been decimated by the re-engineering and downsizing of the past few decades. At the top of the civil service the attrition rate will be even higher. This means that everyone will have to fight harder for young talent, as well as learning to tap (and manage) new sources of talent.

At the same time loyalty to employers is fading. Thanks to all that downsizing, the old social contract—job security in return for commitment—has been breaking down, first in America and then in other countries. A 2003 survey by the Society for Human-Resource Management suggested that 83% of workers were “extremely” or “somewhat” likely to search for a new job when the economy recovered.

As well as becoming more footloose, the workforce is becoming less standardised. Today employees come in all shapes and sizes. Some 16% of American workers telecommute some of the time. A quarter of the staff at B&Q, a British DIY chain, are over 50; the oldest is 91. And these diverse workers are

often part of a global supply chain that keeps going 24 hours a day. Managers not only need to deal with lots of different sorts of people, but also to manage workers in different countries and often across different functions. That means even more competition for people with up-to-date management skills.

Obsession with talent is no longer confined to blue-chip companies such as Goldman Sachs and General Electric. It can be found everywhere in the corporate world, from credit-card companies to hotel chains to the retail trade. Many firms reckon that they have pushed re-engineering and automation as hard as they can. Now they must raise productivity by managing talent better.

With opportunities at home running dry, the hunt for talent has gone global. Over the past decade multinational companies have shipped back-office and IT operations to the developing world, particularly India and China. More recently they have started moving better jobs offshore as well, capitalising on high-grade workers with local knowledge; but now they are bumping up against talent shortages in the developing world too.

Even governments have got the talent bug. Rich countries have progressed from simply relaxing their immigration laws to actively luring highly qualified people. Most of them are using their universities as magnets for talent. India and China are trying to entice back some of their brightest people from abroad. Singapore's Ministry of Manpower even has an international talent division.

The dark side

Competition for talent offers many benefits—from boosting productivity to increasing opportunities, from promoting job satisfaction to supercharging scientific advances. The more countries and companies compete for talent, the better the chances that geniuses will be raked up from obscurity.

But the subject is strewn with landmines. Think of the furore that greeted Charles Murray's and Richard Herrnstein's book “The Bell Curve”, which argued that there are differences in the average intelligence of different racial groups; or the ejection of Lawrence Summers as president of Harvard University because he had speculated publicly about why there are so few women in the upper ranks of science.

It would be wonderful if talent were distributed equally across races, classes and genders. But what if a free market shows it not to be, raising all sorts of political problems? And what happens to talented Western workers when they have to compete with millions of clever Indians who are willing to do the job for a small fraction of the price?

This survey will argue that the talent war has to be taken seriously. It will try to avoid defining talent either too broadly or too narrowly but simply take it to mean brainpower—the ability to solve complex problems or invent new solutions. It will thus focus on what Peter Drucker, the late and great management guru, called “knowledge workers”. But there is no point in being dogmatic. The nature of critical talent varies from company to company: it may be the ability to crack a few jokes while turning an aeroplane around in 25 minutes, as demonstrated by Southwest Airlines. It is one of the marks of a sophisticated society that it rewards a wide variety of different talents.

The survey will conclude by looking at the widening inequalities that will result from the competition for talent, and weighing up the risks of a backlash against the talent elite.

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Everybody's doing it

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Companies of all stripes have become aware of the need to gather talent

THERE is nothing new about companies wanting to secure the best talent. The East India Company, founded in 1600, used competitive examinations to recruit alpha minds. The company's employees included James and John Stuart Mill, two of Britain's greatest intellectuals, and Thomas Love Peacock, one of its wittier writers. General Electric (GE) carefully ranks its employees, with the best groomed for leading positions and the weakest eased out. In the mid-1950s it launched its corporate university at Crotonville near New York, often dubbed Harvard-on-the-Hudson. Jack Welch, the company's legendary boss, spent half his time on “people development” and visited Crotonville every two weeks. As for investment banks and consultancies, they have to be obsessive about talent: what else are they selling?

But now something new is in the air. Thanks to a hyper-competitive labour market, professional-service firms have become more preoccupied with talent than ever; and even companies in more mundane businesses have begun to think that they cannot manage without it.

The 1990s were a time of galloping growth for professional-service firms. Jay Lorsch, of Harvard Business School, and Thomas Tierney, head of the Bridgespan Group, have produced some striking figures, showing that global revenue across the industry leapt from $390 billion in 1990 to $911 billion in 2000. Companies became both much bigger and much more global: by 2000 PricewaterhouseCoopers had over 9,000 partners, and McKinsey had 81 offices worldwide. There was a frenzy of mergers and acquisitions: America alone saw 7,638 of them in 1995-2000, worth a total of $471 billion. And lots of newcomers entered the market in the 1990s—2,300 advertising firms, 2,600 accounting firms and nearly 50,000 freelance consultants. This rapid growth faltered a bit when the dotcom bubble burst, but is now resuming.

Headlong expansion has created serious problems for professional-service firms. They have to work harder to woo potential recruits, particularly potential stars, not just from each other but also from high-tech companies. And they have to turn their recruits into company men in double-quick time. This has led them to pay even more attention to talent.

Goldman Sachs, for example, underwent a wide-ranging internal review in 1999, complete with benchmarking against industry leaders. It increased its emphasis on formal training, setting up a Goldman Sachs University, and encouraged senior partners to put more effort into developing talent. McKinsey's People Committee has spent the past two years fine-tuning its talent machine. It has boosted its training budget to $100m, diversified its sources of recruitment and rejigged its internal organisation to appeal to well-qualified young people.

The triumph of the HR department

Managing talent has become more important to a much wider range of companies than it used to be. One result has been that human-resources departments, which used to be quiet backwaters, have gained in status. A survey by Aon, a consultancy, identified 172 HR executives who were among the five best-paid managers in their companies. That would have been unheard of a few years ago. The biggest earners among them worked for some surprising companies, such as Black & Decker, Home Depot, Pulte Homes, Viacom and Timberland. Companies are also trying to give their people-managers better tools. The Yankee Group estimates that last year over 2,300 companies worldwide adopted some form of talent-management technology and predicts that the market for such technology will nearly double by 2009.

Talent-intensive companies have provided both a model and a training school for the corporate world. GE is America's CEO factory: when Mr Welch chose Jeffrey Immelt to succeed him in 2001, two of his disappointed rivals, Bob Nardelli and Jim McNerney, were immediately snapped up by Home Depot and 3M respectively. It is also an inspiration: there are now 1,600 corporate universities loosely modelled on Crotonville. Consultancies and investment banks have become finishing schools for future corporate leaders: Lou Gerstner at IBM, Ken Chenault at American Express, Meg Whitman at eBay and Chuck Conaway at K-Mart all started out in consultancies (as do 65% of the products of top business schools).

Capital One, a credit-card company, shows what a difference the application of talent can make to a sleepy market. The company's headquarters, in McLean, Virginia, looks more like a consultancy than a bank. The atmosphere is informal. The staff is young and “data-centric”. The formula seems to work: founded in 1995, Capital One is now number four in the American credit-card market. Last year it doubled its number of employees to 20,000.

The company's success is due to the deployment of lots of brainpower in a business generally seen as unexciting. The founders, Rich Fairbank and Nigel Morris, were both products of MBA programmes and consultancies. They decided that they could use mass customisation to compete with financial giants such as American Express, recruited a high-powered team of former consultants and used sophisticated statistical techniques to slice the credit-card market into tiny segments.

To-do list

Companies are now beginning to gain insights into managing talent that should allow them to tackle the problem in a more organised way. The first rule is to think more carefully about their critical talent. Deloitte, a consultancy, offers a useful example of how UPS reduced the turnover rate among the people who drive its trucks and deliver its packages. Big Brown had found that even though it selected its drivers with great care, turnover was uncomfortably high, mainly because drivers hated the back-breaking work of loading the trucks in the morning. So the company contracted out this job to part-timers who are much easier to find than drivers.

Second, it is essential to plan ahead. EDS, a giant technology company, has built a global skills inventory of its 100,000-strong workforce. The company compared the workforce's current skills with its future needs and set about filling the gaps by encouraging workers to acquire the relevant skills. Schlumberger, a Franco-American oil-services group, is preparing for an expected skills shortage in the next few years by asking its managers to cultivate successors, and holding rigorous inquests when a high-flyer jumps ship.

Third, companies need to be more imaginative about recruiting and retaining talent. That includes paying more attention to “passive candidates”—those who are not actively looking for a job but might be open to seduction (see chart 2). Popular techniques include going through lists of people attending conferences in order to buttonhole stars, buying information about competing firms (including names of key workers) and searching the web for people who have created new patents.

High attrition rates in the first few months have also persuaded companies to pay more attention to keeping new recruits on board. In the late 1990s American Express found that far too many of its new managers were leaving within the first two years. It now gives them a chance to work on projects that are overseen by the CEO, as well as providing them with “assimilation coaches”. Companies are also cultivating relations with former alumni. Ernst & Young, a consultancy, fills about a quarter of its vacancies from this source.

The fourth rule is to create internal markets for talent. Many HR departments instinctively look outside. Deloitte calculates that the typical American company spends nearly 50 times more to recruit a professional on $100,000 than it spends on his or her further training every year. Moreover, new recruits can take more than a year to learn a job. One solution is to establish an internal market, encouraging workers to apply for jobs across the company. Schlumberger encourages its employees to post detailed CVs on the company intranet; McKinsey allows consultants from all over the world to apply for any project within the company.

One difficulty with implementing these ideas is that there is no consensus about who is responsible for managing talent. If the CEO is in charge, he may well be distracted by too many other responsibilities; if it is the head of HR, he may lack the institutional heft to get much done.

Herding cats

Nor, indeed, is there a consensus on the best way to manage talent. Part of the problem is that HR as a discipline has not achieved anything like the level of sophistication of, say, finance. But more importantly, the more valuable the talent, the more difficult it is to manage. In business, as everywhere else, world-class talent sometimes comes in unexpected guises. Ray Kroc sold milkshake machines to restaurants before starting to build McDonald's at the age of 52. David Ogilvy was a chef, a farmer and a spy before becoming an advertising genius.

And solutions that have proved successful in one place do not necessarily work in another. On arriving at Home Depot in 2000, Mr Nardelli was determined to apply the lessons he had learned at GE to reinvigorate the DIY giant. He appointed a colleague from GE, Dennis Donovan, to run the HR side, and boosted his credentials by paying him the second-highest salary in the company. He replaced the company's ad hoc talent-management system with a much more formal one, creating a leadership development institute, employing more human-resource managers and imposing an elaborate system of performance measurement. But the results have been mixed. Home Depot's share price is now somewhat lower than it was when Mr Nardelli took over. Wal-Mart and Lowe's are providing stiff competition. And there is widespread disgruntlement about Mr Nardelli's giant pay package. Demoralised employees have taken to calling the company “Home Despot”.

Still, Mr Nardelli's record is unlikely to discourage other companies from trying to find ways to get on top of the problem. They are motivated by a powerful combination of fear and hope: fear of talent shortages and hope that they can be turned into a source of competitive advantage. Those hopes often involve shopping for talent in the developing world.

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The world is our oyster

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The talent war has gone global—and so have talent shortages

THE Infosys campus on the outskirts of Bangalore looks like a chunk of the rich world that has been reassembled amidst the dust and debris of India. The echoes of Silicon Valley are everywhere. The journey there involves a wild ride along dirt roads, but the 22-hectare (54-acre) campus itself is all cut grass and neatly planted flowers. It has every possible amenity, from gyms to yoga studios, from banks to bowling alleys. The restaurants serve 14 different cuisines. Many of the buildings are in the low-slung Californian style, but some of the largest are modelled on Western icons, such as the Sydney Opera House, the Louvre pyramid or Rome's Basilica of St Peter.

Infosys Technologies was started in 1981 by seven Indian entrepreneurs with 10,000 rupees (about $1,000 at the time) between them. The software giant now has annual revenues of $2.2 billion and 58,000 employees. But it is just one of a hundred companies in Bangalore's Electronics City. Bangalore is India's software capital, with 140,000 software engineers (more than in Silicon Valley, the locals boast), and Electronics City is a custom-built high-tech haven. The signs are a list of the world's biggest IT companies, from multinationals such as Hewlett-Packard and Motorola to home-grown giants such as Infosys and Wipro.

Electronics City is the meeting point of the West's demand for high-tech services and India's supply of brain power. The dramatic fall in the cost of communications made it possible for Western companies to outsource services, and a newly liberalised India could offer a huge supply of cheap brain workers. Every year India produces around 2.5m university graduates, including 400,000 engineers and 200,000 IT professionals. India's National Association of Software and Service Companies (NASSCOM) calculates that the country has 28% of the world's IT offshore talent.

Indians point to the advantages that they bring to the market. They work while the West sleeps; they speak (splendid) English; they can throw huge numbers of people at a job. But at the heart of the boom is a simple sum. The cost of an Indian graduate is roughly 12% of that of an American one. Indian graduates also work more: an average of 2,350 hours a year compared with 1,900 hours in America and 1,700 in Germany. The bottom line is that you can buy almost ten Indian brains for the price of one American one.

The outsourcing boom shows no sign of slowing. Gartner, a research firm, estimates that global spending on IT outsourcing will rise from $193 billion in 2004 to $260 billion in 2009. But there are caveats. The most important is that Indian-based companies themselves are encountering severe skills shortages. Wage inflation in India's IT sector is about 16% a year, and turnover is 40%. NASSCOM predicts that India's IT sector will face a shortfall of 500,000 professionals by 2010. GE Capital has posted signs in its Indian offices saying “Trespassers will be recruited”.

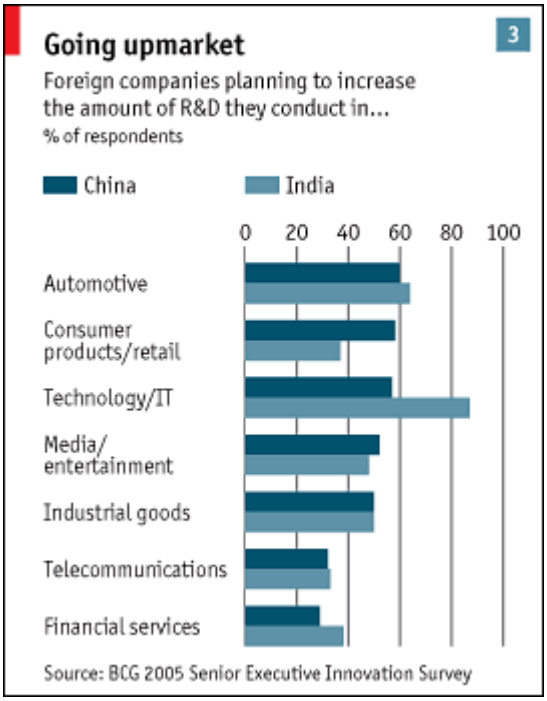
Skills shortages are at their most acute among managers. Several Indian companies have had to bring in Western CEOs: the Tata Group, for example, has put Raymond Bickson, a Hawaiian, in charge of its hotel business. Good middle managers are rare: annual wage increases for project managers in IT have averaged 23% a year over the past four years.

Aspiring to world class

How can a country with a billion people suffer from talent shortages? Some reasons are familiar. The number of people with relevant skills is tiny: only 11% of the relevant age group go on to higher education, and older people have had their management skills blunted by the old licence raj. Moreover, growth is so fast that it would strain any educational system, let alone one as ramshackle as India's. For example, in the four years to March 2006 Infosys increased its payroll from about 10,700 to over 58,000—a compound annual growth rate of 53%.

The second caveat is that Indian-based companies are determined to move upmarket. They have mastered the basics: almost 400 of the companies ranked highest by the Software Engineering Institute at Carnegie Mellon University are in India. Now they want to become world-class. This means pushing into more sophisticated areas such as “integrated solutions” and consulting. It also means adopting the latest productivity-boosting techniques, such as applying lean-manufacturing techniques to software development, a favourite strategy at Wipro. At the same time Western multinationals are exporting more and more complicated tasks.

The looming skills shortage and the drive upmarket have made companies obsessive about finding and holding on to the right people. They are investing heavily in education and training, partly to attract the best talent and partly to keep their existing workers up to speed. “We're investing in training like the Dickens,” says Nandan Nilekani, Infosys's CEO. The company has increased its training budget from $100m to $125m. It has also moved one of its board members, T.V. Mohandas Pai, from chief financial officer to director of human resources to show that it means business. In the year to March 2006 Infosys screened 1.4m applications, tested 164,000 applicants and interviewed 48,700 to make 21,000 appointments.



Companies are also getting much more imaginative about identifying new sources of talent. Wipro has different training programmes for different talent pools, including one to help people get a university degree while working for the company. Mr Pai describes Infosys as a “human-capital supply-chain company”. But to keep the supply chain going, India must improve its universities.

Versions of Bangalore's Electronics City are in evidence in a number of developing countries, and so are skills shortages. China is seeing double-digit wage inflation and labour turnover in its IT sector. Senior managers are particularly scarce: two in three companies report difficulties in filling senior positions. Shanghai Automotive, China's biggest carmaker, and Lenovo, its biggest computer-maker, have recently hired American bosses. But other skills are also in short supply: Chinese airlines, for instance, are importing pilots.

If Western companies were initially attracted to the developing world by the low price of talent, they have now moved on to other considerations. Srini Koppolu, the head of Microsoft's India Development Centre (MSIDC), explains that one reason why Microsoft established a development centre in Hyderabad was to gain an edge in the talent war. Being in India gives you access to first-rate techies who do not want to move abroad. MSIDC has grown from 20 employees in 1998 to over 900 today.

The other advantage is local knowledge. Vijay Mahajan, a former dean of the Indian School of Business, which sits next to Microsoft's campus, points out that the developing world is a booming market as well as a huge labour pool. GE calculates that 60% of its growth over the coming decade will come from the developing world, compared with 20% over the past decade. And the only way to understand the new market is to be immersed in it.

Many Western companies thought that their goods would almost sell themselves in the developing world. They reckoned without complicated distribution systems, feisty local competitors and idiosyncratic local habits. Packaged-goods companies found that customers did not want their jumbo packets, for example, because they had little money and little storage space. Local people could have told them that.

Hewlett-Packard has set up research facilities in India in the hope of building a stripped-down 5,000-rupee ($109) computer. Electrolux Kelvinator has developed a refrigerator that will stay cold even after a six-hour power failure. Nokia has produced a mobile phone that includes a built-in flashlight and a dust-resistant keypad. In GE's John F. Welch Technology Centre in Bangalore, 2,200 highly qualified engineers work as part of digitally connected global teams on products as diverse as aircraft engines, power and transport systems and plastics. Cisco's and Motorola's Indian research centres are their largest outside America.

Most of these companies have research arms in China as well. Microsoft's development centre in Beijing is a world leader in graphics, handwriting recognition and voice-synthesisation. Motorola has 16 R&D centres in China. Samsung has set up a handset laboratory with a staff of 300 in Beijing, and Siemens has moved a chunk of its mobile R&D to China.

Think global

This R&D boom in the developing world is part of a bigger trend: the globalisation of R&D. This allows companies to plug into national clusters of excellence (South Korea has been a trailblazer in digital displays, for example, and Israel has an edge in wireless telecoms). It gives multinationals access to once secretive university labs in Shanghai and Moscow. And it speeds up innovation, because global teams can work around the clock.

Still, it is one thing to send humdrum work to Electronics City and supervise high-tech drudges, quite another to outsource bits of your core business and manage world-class skills. That involves much more than co-ordinating activities across geographical boundaries. For example, how do you disperse innovation around the world without weakening your corporate culture? How do you motivate high-flyers from different cultures? And how do you manage prima donnas across borders? You need world-class management talent, and that, too, is extremely scarce.

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Opening the doors

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Governments are joining in the hunt for talent

IMMIGRANTS tend to get a bad press. In reality, though, many economies would be lost without them, and many governments are desperate to attract them. The most mobile people are not the poor but the educated, and they are sought after as never before.

Most governments are easing restrictions on the entry of skilled workers. Some are going further and offering incentives. Germany has made it easier for skilled workers to get visas. Britain has offered more work permits for skilled migrants. France has introduced a “scientist visa”. Many countries are making it easier for foreign students to stay on after graduating. Canada and Australia have not only tilted their long-established points systems further towards the skilled, they have also introduced more incentives. Canada experimented with a tax holiday for citizens returning from the United States before realising that this encouraged temporary emigration. Ireland's government works hard to recruit overseas talent.

The most ambitious programme for drawing in brains from abroad is—where else?—in Singapore. Lee Kuan Yew, the city-state's elder statesman, has long argued that “trained talent is the yeast that transforms a society and makes it rise.” At first Singapore focused on wooing its émigrés. Now it is going out of its way to import foreign talent. Only 3% of companies experienced problems with the immigration authorities, compared with 24% in China and 46% in the United States. Singapore is particularly keen to attract scientific talent, mainly in biotechnology. Of the 170 staff working in the country's Genome Institute, about 120 are foreigners. Alan Colman, a member of the Scottish team that cloned Dolly the sheep, is also based in Singapore now.

Enroll here

Many countries regard universities as ideal talent-catching machines, not only because they select students on the basis of ability but also because those students bring all sorts of other benefits, from spending money to providing cheap research labour. France is aiming to push up its proportion of foreign

students from about 7% now to 20% over time. Germany is trying to create a Teutonic Ivy League and wants to “internationalise studies in Germany”. Both countries are offering lots of courses in English. In Singapore a fifth of the students at public universities are foreign, thanks in part to heavy subsidies. Australia and New Zealand have created a ladder leading from universities to the workforce and then to permanent residence. China, which temporarily dispensed with entrance examinations during the Cultural Revolution, is focusing resources on its elite universities.

But government schemes can make much of a difference only if they are backed up by a vibrant economy, and only if cultural resistance can be overcome. No matter how much Japan speeds up the processing of scientific visas, it will not attract more foreigners unless Japanese firms are prepared to give them senior jobs.

Still, a combination of sensible government policies and economic liberalisation can work wonders, as Ireland has demonstrated. A country that has exported people for centuries is now a net importer. Britain has also seen a surge in the number of skilled people arriving from both the rich and the developing world, thanks to the Labour government's more immigrant-friendly policies since taking office in 1997. The share of skilled people in total immigrant arrivals increased from 7% in 1991 to 32% in 2001.

Some of the best prospects in the competition for talent are émigrés—people who have gone abroad to make their fortune but still feel the tug of their home country. Both China and India are now trying to emulate Ireland's success in wooing back the diaspora, but China is trying harder. In 1987 the Communist Party's general secretary, Zhao Ziyang, described China's brain drain as “storing brain power overseas”. Officials from every level of government have been raiding the store since, as part of a policy of “strengthening the country through human talent”.

They have introduced a mind-boggling range of enticements, from bigger apartments to access to the best schools, from chauffeur-driven cars to fancy titles. The Chinese Academy of Sciences has established a programme of generous fellowships for expats—the “hundred talents programme”. Beijing has an office in Silicon Valley, and Shanghai has established a “human talent market”. China is littered with shiny new edifices labelled “returning-student entrepreneurial building”.

All this coincides with a change in the flow of people. For decades returnees were rare. The numbers began to shoot up in 2000, when the bursting of the Silicon Valley bubble coincided with rapid growth in China. Despite doubts about the quality of some of these people, there is growing evidence that China is going in the same direction as South Korea and Taiwan—first tempting back the diaspora (see chart 4) and then beginning to compete for global talent.

India has taken a different approach. The government has relied as much on the goodwill of prominent businesspeople as it has on the wisdom of bureaucrats; it has also cast its net wider, focusing not just on luring back expats but also on putting the wealth and wisdom of the diaspora to work on behalf of the mother country. There are an estimated 20m Indians living abroad, generating an annual income equal to 35% of India's gross domestic product. The Indian government is doing what it can, in its haphazard way, to let them participate in the Indian boom, making it easier for them to invest back home and streamlining visa procedures. There is a special visa for “people of Indian origin”.

Come back, all is forgiven

Again, government policy has coincided with a change in the flow of people. NASSCOM estimates that in 2001-04 some 25,000 Indian techies returned home, and the number is rising rapidly. A survey of Indian executives living in America found that 68% were actively looking for opportunities to return home, and 12% had already decided to do so; and a survey of graduates of the elite All India Institute of Medical Sciences who were living abroad found that 40% were ready to go home.

For years, discussion of the cross-border flow of talent has sounded a sombre note. For some critics it is nothing less than a new form of colonialism. The rich world, they say, is not only appropriating the developing world's best brains but getting them on the cheap, with their education paid for by someone

else. One study of 55 developing countries found that a third of them lost more than 15% of their graduates to migration. Turkey and Morocco lose 40% and the Caribbean countries 50%. But in recent years some of the gloom has lifted.

In fact, it was always overdone. Migrants sent huge amounts of money home in remittances: $126 billion in 2004, according to the International Monetary Fund. They also transferred knowledge and connections. The current Indian boom owes much to successful Indians who emigrated in the 1960s and 1970s and who are now determined to modernise their home country. They have formed support groups such as Indus Entrepreneurs, steered multinational contracts to India, established venture-capital funds and helped found business schools.

But what has recently helped to change the mood is that the flow is no longer one way. The brain drain is giving way to brain circulation, and returning émigrés are turning into economic dynamos. One example is Dr Prathap Reddy, a returnee from America, who established the Apollo Hospitals Group, one of Asia's largest and the first to attract foreign investment.

Refreshing effect

Returnees seem to have a spring in their step. In Ireland they enjoy a 10% wage premium over their stay-at-home compatriots. In China they receive more grants and fellowships than their domestic competitors. A third of Taiwan's companies were founded by returnees from America.

What the talent elite everywhere has in common is that it is more mobile than the rest. Two economists, Frédéric Docquier and Hillel Rapoport, estimate that average emigration rates worldwide are 0.9% for the low-skilled, 1.6% for the medium-skilled and 5.5% for the high-skilled. These rates have been accelerating far faster for the high-skilled group than for the rest. Skilled immigrants accounted for more than half of all admissions in Australia, Canada and New Zealand in 2001.

The global war for talent is likely to intensify. Most developed countries are already struggling to find enough doctors and teachers, and are wondering how they will manage when the baby-boomer generation retires. Developing countries, for their part, realise that they will not be able to plug into the global knowledge economy unless they give their people the freedom to move around. A powerful array of interests, from multinationals to city politicians, supports the idea of a global market for the best people. Countries cut themselves off from it at their peril.

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Nightmare scenarios

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Western worries about losing jobs and talent are only partly justified

INDIA'S high-tech enclaves exude euphoria. Proud techies take their parents on tours of company campuses. Proud parents boast that their children earn more than the rest of the family combined. Mr Nilekani of Infosys says that his company's greatest achievement is not its $2 billion turnover but the fact that it has taught Indians to redefine the possible.

The mood in America, the country that is driving the outsourcing boom, could hardly be more different. People view the global war for talent with foreboding. Their fears take two forms. The first is that well-paying jobs in services will follow manufacturing jobs to the developing world. Norman Augustine, a former boss of Lockheed Martin, says that “virtually no one's job seems safe.” Craig Barrett, the chairman of Intel, admits that “I worry for my grandchildren.”

The second fear is that America may no longer be able to attract more than its fair share of the world's brains. Half the Americans who won Nobel prizes in physics in the past seven years were born abroad. More than half the people with PhDs working in America are immigrants. A quarter of Silicon Valley companies were started by Indians and Chinese. Intel, Sun Microsystems and Google were all founded or co-founded by immigrants. But now India and China are sucking back their expats, and America's European competitors have woken up to the importance of retaining their talent. To cap it all, the immigration authorities are making life harder for foreigners.

Are Americans right to worry? One misconception is that the number of jobs is fixed, so if some of them go abroad there must be fewer left at home. If a farmer in Palo Alto in 1900 had been told that in a hundred years' time agricultural workers would account for only 2% of the American workforce, he would have expected the Valley to become a desert rather than a global technological hub. But even if the number of good jobs were fixed, the fears of a great job migration are exaggerated.

The McKinsey Global Institute has conducted a large-scale study of the offshoring market and concluded that constraints on both the demand and the supply side will keep the number of service jobs moving offshore much lower than is widely believed. It will probably rise from 1.5m in 2003 to 4.1m in 2008, or 1.2% of the demand for labour in the developed world. That figure is dwarfed by the normal job churn in America, where 4.6m Americans start with a new employer every month.

There is clearly plenty of eager talent in the developing world. But McKinsey argues that only about 13% of that talent is capable of working for a Western multinational in a high-grade job at the moment (although the stock of suitable professionals is expanding a lot faster in developing than in rich countries). There are problems with cultural and language skills, particularly in China. The quality of education is often inadequate. China may have twice as many engineering graduates as America, but only 10% of them are equipped to work for a Western multinational. Geography also imposes limits. In

large countries such as India and China many graduates live far away from international airports. In China only about half the talent pool is accessible to multinationals, according to McKinsey.

There are other worries too. In his recent book, “Three Billion New Capitalists: The Great Shift of Wealth and Power to the East”, Clyde Prestowitz quotes a Chinese friend: “We've had a couple of hundred bad years, but now we're back.” Yet shrugging off the burden of history is not so easy, particularly when, as recently as 1966-76, the brightest and sparkiest people were dumped in labour camps. The Chinese have been able to turn their country into a manufacturing giant because of their willingness to work harder and longer; but turning it into a service giant, let alone an innovation hub, will require different qualities.

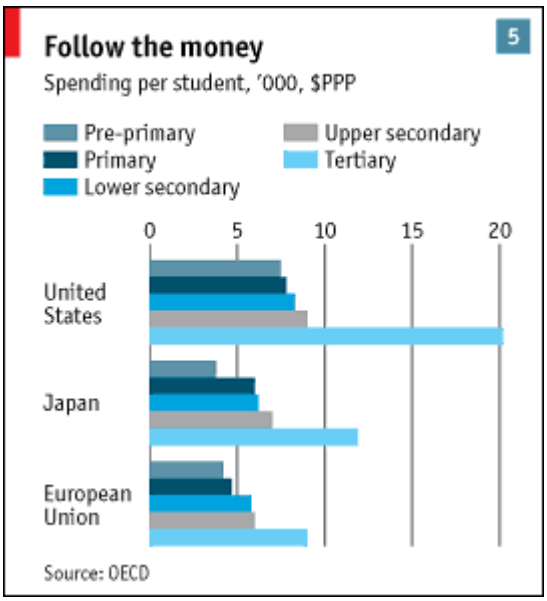
China's biggest problem is a culture of deference—a culture that was refined by the mandarin tradition and then reinforced by the Communist Party. For many Chinese it is bad form to question superiors. So far, China has been much more adept at borrowing other people's ideas than producing its own, particularly when it comes to high-level innovation. But there are plenty of other problems, ranging from poor English-language skills to weak intellectual-property rights. Many Western companies are rightly nervous about developing new products in a country where ideas are routinely stolen.

India's difficulties have more to do with another intractable problem: poor government. The country's infrastructure is crumbling and the education system is hugely uneven. The Indian Institutes of Technology are very good at producing a highly educated elite, but run-of-the-mill colleges are often of poor quality. The result is graduate unemployment of 17% at a time when the high-tech economy is booming.

Don't overdo the gloom

Americans are right to worry about losing out in the international competition for talented people, particularly as highly qualified Indians and Chinese based in America go home. America's immigration system is hopelessly antiquated, geared more towards reuniting families than attracting high-quality workers. The 2005 allocation for H1B visas for skilled workers ran out on the first day of the fiscal year. The terrorist attacks of September 11th 2001 have made things worse. Students complain that they have to wait months for a visa, and some decide to accept offers elsewhere. One-third of American companies report serious delays in bringing skilled employees into the country.

But again these worries are exaggerated. America remains the world's number one destination for foreign students, soaking up almost 30% of the global supply. There is every reason to think that the absolute number of people from India and China who want to study in America will rise as those countries get richer. It is true that some foreigners who might have stayed in America a few years ago are going home. But David Zweig, of the Hong Kong University of Science and Technology, argues that the best Chinese students remain abroad. The pattern of geographical mobility is likely to get more complicated in the future as people divide their careers between the developed and the developing world, but America is unlikely to be denuded of talent.



Another concern is that America is suffering from a brain drain from science and engineering, starting in high schools, where there are too few teachers qualified to teach difficult subjects and too few pupils willing to grapple with them. The Higher Education Research Institute at the University of California at Los Angeles found that the proportion of incoming undergraduates planning to major in computer science is now 70% below its peak in the early 1980s. But here, too, things are not as bad as they seem. Many of the figures that have set alarm bells ringing—those millions of Chinese engineers, for example—are misleading because they fail to take quality into account. McKinsey calculates that, in 2003, America had far more young engineers who were capable of working for multinational companies than China—540,000 against 160,000.

Besides, the argument is based on a misunderstanding of how science progresses. America does not become less competitive because China invests more in science; indeed, outside highly proprietary areas, Chinese investment in science will help to advance scientific knowledge in general.

America still has overwhelming advantages in the war for talent. One is the quality of its universities, which regularly dominate global league tables. The second is the quality of its business environment—from the availability of venture capital to the quality of its management cadre to its willingness to pay for the best people. The state of California alone has more venture capital than any country outside the United States. Robert Huggins Associates, a British-based economics consultancy, found that the world's top seven regional “knowledge economies”, measured by things such as patent registrations, investment in R&D and the proportion of knowledge workers, were all in the United States.

Europe has less reason to be cheerful than America. Business is burdened by rigidities and regulations. The universities are not what they were. The EU invests 30% less in R&D than America does, and most of its 400,000 researchers working on the other side of the pond have no intention of returning. Yet Europe, too, still has huge strengths in the “tacit” skills that are at such a premium in a knowledge economy. Germany has deep expertise in engineering, Italy in design and Finland in wireless technology. Europe is also doing more than America to reform its immigration system in hopes of attracting talent. All the same, Europe needs to get serious about freeing its economy and its universities from intrusive controls.

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Masters of the universe

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The war for talent is shifting the balance of power from companies to workers

THE world headquarters of what its proprietor jokingly calls “Pink Inc” is in the attic of a redbrick house in north-west Washington, DC. Children's pictures decorate the walls; highbrow novels are jumbled up with business books. Daniel Pink spent much of the 1990s working for the Clinton administration, ending up as chief speechwriter for Al Gore. But in the late 1990s he decided to branch out on his own. He now makes his living as what he calls a “free agent”—doing a bit of consulting, giving speeches, writing articles (he is a contributing editor to “Wired”) and books, including, in 2001, a book about people like himself, “Free Agent Nation: How America's New Independent Workers are Transforming the Way We Live”. Mr Pink has no doubts about the changing balance of power in the corporate world: “Talented people need organisations less than organisations need talented people.”

Part of the reason is technology. Mr Pink calls it “Karl Marx's revenge”: the means of production, in the form of computers, are now in the hands of the workers, often literally, “cheap enough to buy, small enough to house and easy to operate”. The most dramatic example of the power of ordinary people is the so-called pyjama revolution. Bloggers have repeatedly outflanked the mainstream media on domestic political news. Glenn Reynolds, a law professor at the University of Tennessee, with no background in the media, gets half up to half a million page views a day for his blog, instapundit.com.

At the same time organisations are losing many of their bargaining chips, such as being able to offer job stability and security. Starting in the 1980s, many corporations tore up the old corporate contract—a permanent job in return for the employee's loyalty—first in America and then in much of the rest of the world. Even companies that wanted to provide such jobs had a hard time delivering them. Of America's 100 biggest industrial firms in 1974, half had disappeared by 2000. Mr Pink argues that free agents may actually enjoy better security than people with regular jobs: they diversify their risks rather than relying on the wisdom of their bosses.

The upshot is a steady decline in the number of people willing to wear the company collar. The number of one-man businesses in the United States is growing by 4-5% a year. At the same time, the average length of job tenure for American workers has shrunk: the median period for which men aged 55-64 had been with their current employers declined from 15.3 years in 1983 to 10.2 years in 2000. Some of this movement is no doubt involuntary, but some of it reflects a disenchantment with their current employers. A survey by Hewitt Associates, a consultancy, found that 40% of employees expressed an interest in working somewhere new. The Conference Board discovered that 40% of mid-level managers maintained relationships with professional recruiters.

The shift in the balance of power between workers and organisations is particularly noticeable among top talent and among young workers. Being a free agent is fashionable among sports stars and Hollywood celebrities. Technology stars routinely hop from job to job. A growing number of high-flying managers change organisations on the way to the top. Companies that have recruited CEOs from outside in the past few years include Hewlett-Packard, 3M, Boeing, Merck, Kodak, Motorola, Honeywell and Home Depot.

Young high-fliers are also finicky about jobs. They have a strong sense of their market value: unemployment among American graduates is currently around 2%, and that is before the baby-boomers have started to retire in earnest. They also have access to inside information, from websites such as vault.com, where they can find unofficial accounts of what it is like to work for a particular organisation,

and salary.com, which gives them a good idea of what they can expect to earn.

The discreet charm of the water cooler

But organisations still have a few things going for them. First, many people actually enjoy the sense of belonging and the rituals of office life. Second, the best companies are repositories of skills that are hard to replicate. Talent may reside in the brains of individuals, but it is also nurtured by organisations.

This was underlined by a study of star security analysts in American investment banks in 1988-96, conducted by Boris Groysberg of Harvard Business School and Ashish Nanda of Harvard Law School. These analysts might look like the perfect free agents. Their skills are highly portable, and if they want to change jobs all they have to do is walk across the street. In fact, the research showed an immediate decline in their performance if they switched employers. This was most marked for those who moved to lower-rated firms and did not take other members of their team with them, but was noticeable even for those who moved between similar firms. Talented people may think that their brainpower allows them to walk upon water, but in reality many are walking on the stones that their employers have conveniently placed beneath them.

What should companies do to convince brainy people to work for them? The Corporate Executive Board argues that they need to focus on their “employment value proposition”. The EVP is what employees gets out of working for a particular organisation. Obviously pay and benefits are a big part of that. But there is much more—from a congenial culture to the chances to develop their skills.

On the basis of a detailed study of about 90 companies, the Corporate Executive Board argues that the rewards for managing an EVP effectively are huge, increasing a company's pool of potential workers by 20% and the commitment of its employees fourfold. It can even reduce the payroll: companies with well-managed EVPs get away with paying 10% less than those with badly managed EVPs. But most companies are falling down on this job. Three-quarters of new recruits feel that their employers are failing to deliver on their promises, making the recruits feel less committed to their work.

Companies need to put more effort into defining their EVP, says the CEB. Most human-resources departments put the emphasis on the company's ethos, but potential employees are more concerned about rewards and opportunities. Companies also need to fine-tune their EVPs for different segments of the talent market, and particularly for different geographies, which account for most of the differences in what employees are looking for. Americans are keenly interested in health and retirement benefits, whereas Indians emphasise growth rates and innovation.

Companies also need to devote much more effort to getting their message out. Most people are cynical about information in advertisements (except, oddly, in India). They put much more trust in what current and former employees say. Companies have to find ways to turn informal networks into recruiting tools. Mitre, an engineering company, operates in a tight market for talent, with low unemployment for software engineers and big-name competitors such as Lockheed Martin. The company improved its recruitment by encouraging its existing employees to act as “champions”, telling them what sort of people it was looking for and asking them to get involved.

Seat of learning

The most important thing that companies can do to attract talented people is to boost their workers' long-term employability. Employees no longer expect companies to offer job security (according to one survey, 94% of those questioned thought that it was they, not their employers, who were responsible for that). But they do expect their employers to help them keep their skills up to date.

This may not be as simple as it sounds. Most companies make much of their corporate universities and their online training, but there is often less to these than meets the eye. The CEB found that company investment in learning and development in America in 2004-06 barely kept up with inflation. The average company spends only $800 per employee per year, about 1.25% of the annual payroll. The average company provides training for only two-thirds of its employees, and some do much less.

Besides, most employees value informal training more than formal teaching: in a survey by Deloitte, 67% of respondents said that they learn most when they are working with a colleague, with only 22%

saying that they do best when they are conducting their own research, and only 2% happiest with a manual or a textbook.

Clearly the best way for companies to win the talent wars is to turn themselves into learning organisations. The trouble is that few of them know how to do this.

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The revenge of the bell curve

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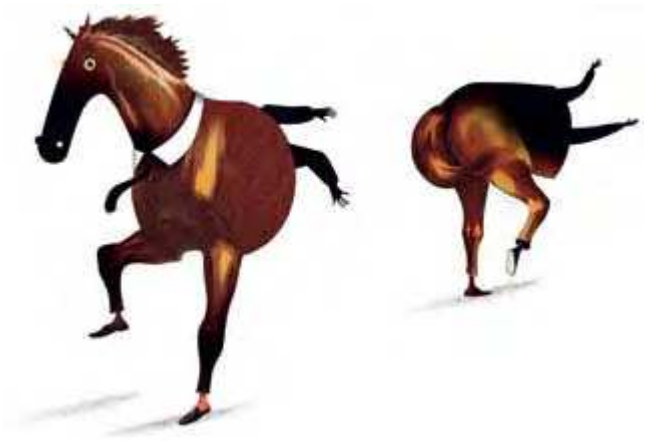

As talent becomes more valuable, inequalities are widening

FRANCIS GALTON, a cousin of Charles Darwin, was a Victorian gentleman-scholar of eccentric genius. He devoted his life to measuring everything imaginable—from the frequency of fidgets in a bored audience to the size of the buttocks of a Hottentot woman (from a discreet distance, using a sextant). But what obsessed him above all was mental distinction. Why were some people cleverer than others? Why did intellectual distinction run in some families? And how were intellectual abilities distributed in the population?

Galton came to two conclusions. The first was that ability owed more to nature than to nurture. The second was that the range of mental powers between the cleverest and the dumbest was enormous—"reaching from one knows not what height, and descending to one can hardly say what depth". He put these together to produce a theory of human inequality: the more open society becomes, the more an aristocracy of talent will replace an aristocracy of birth.

Galton's argument contained a good deal of nonsense. He understated the importance of nurture, and he ignored class privileges. But it did offer an important insight: that a free market in talent could end up widening social inequalities.

The rich get richer

America, the country with the world's freest market in talent, is seeing a dramatic increase in inequality. Emmanuel Saez of the University of California at Berkeley and Thomas Piketty of the Ecole Normale Supérieure in Paris have dissected tax records to examine changes in income distribution, and found that the share of income going to the highest-earning 1% of Americans doubled between 1980 and 2004, to 16%. The share going to the top 0.1% more than tripled over the same period, to 7%.

Part of the reason lies in social convention: Europeans have strong cultural objections to paying their CEOs the sort of salaries that American bosses get. Part of it is political: inequality has risen faster under the Republicans than under the Democrats. The unions are weaker than they were. But a bigger reason is rising returns to talent and skill.

This is most obvious with sports stars and Hollywood celebrities. The picture is a bit murkier when it comes to CEOs. There are well-publicised examples of company bosses who pack their board with cronies and rig their compensation so that they profit whether their company does well or not. On the other hand, the best CEOs, such as Jorma Ollila of Nokia and A.G. Lafley of Procter and Gamble, create huge

value for their organisations. And most of them work in a highly competitive market. The average length of tenure of CEOs is going down, and a growing number of them are recruited from outside. Relative to market capitalisation, by some measures executive pay is now falling.

Top performers are doing well in every field. Even universities, which were once bastions of collegial equality, are willing to pay a premium for academic stars—not only because their ideas are so valuable but also because they will attract other high-flyers. These huge rewards may offend egalitarians, but they make a lot of economic sense. Stars have a dramatic impact on the fortunes of organisations. Alan Eustace, a vice-president of Google, told the *Wall Street Journal* that in his view one top-notch engineer is worth “300 times or more than the average”. Bill Gates says that “if it weren't for 20 key people, Microsoft wouldn't be the company it is today.”

Success in climbing to the top of an organisation requires many kinds of talent. Most consultancies eventually shed 80% of their recruits. Only one in ten law students makes it to senior partner at a top law firm. Managers suffer a huge attrition rate as they move up their organisations.

Trickle-down

Now the tendency for the best to pull away from the rest is spreading down the corporate hierarchy. Companies are determined to keep their wage bill under tight control because they face competitive global markets. But they are also desperate to keep their best talent from falling into the hands of rivals. So they have been keeping their overall wage bill more or less steady but giving a larger share of it to the top performers.

A survey by the Society for Human-Resource Management found that the share of companies taking special measures to keep their best workers rose from 35% in 2004 to 49% last year. A survey by the Corporate Executive Board found that 88% of organisations wanted to increase pay differentials. Those differentials could get a lot wider in the future. The CEB says that the variance in performance increases with the complexity of the job. The best computer programmers are at least 12 times as productive as the average.

The link between talent and inequality is being strengthened by two things. The first is the tendency of talented people to cluster together. You might have thought that the advent of the internet would have eroded the connection between place and talent. In fact, the opposite is happening. Bright people gather in university cities such as Boston and San Francisco, or in technology hubs such as Austin, Texas, or Redmond, Washington, or in rural idylls such as Camden, Maine, and Jackson Hole, Wyoming. They cluster together because they feed off each other's intellect. Christopher Berry, of the University of Chicago, and Edward Glaeser, of Harvard, have studied the distribution of human capital across American cities. They found that in 1970 about 11% of people over 25 had a college degree, and they were fairly evenly distributed throughout the country. Since then the proportion of Americans with college degrees has more than doubled, but the distribution has become much more uneven.

Increasing numbers of high-flyers are moving from inland locations to the coasts: once flourishing cities such as St Louis, Missouri, are losing young talent to New York and Los Angeles. And the places where talent likes to cluster are becoming increasingly unequal, with the talent elite at the top, service workers at the bottom and nothing much in-between. The middle layer is being driven out by sky-high house prices and low-quality public schools. Richard Florida, of George Mason University, points out that the three most unequal metropolises in the country—Raleigh-Durham, San Francisco and Washington-Baltimore—are also hubs of what he calls “creative workers”.

The second factor that links talent and inequality is that members of the talent elite are good at hogging “human capital”. They marry people like themselves. In the heyday of “company man”, bankers married their secretaries; now they marry other bankers. They work in jobs that add to their intellectual capital. They live in “talent enclaves”, away from ordinary middle-class suburbs, let alone inner-city ghettos. Above all, they pass on their advantages to their children. Students from the top income quartile increased their share of places in elite American universities from 39% in 1976 to 50% in 1995.

None of this is peculiar to America or other rich countries; the same thing is happening in the developing world in even starker form. Members of the talent elite there live in gated communities, some of them with American names such as Palm Springs, Napa Valley or Park Avenue, that boast international schools, world-class hospitals, luxury housing and splendid gyms. And they try hard to give their children every possible advantage. One recent bestseller in China, “Harvard Girl”, tells the story of two parents

who trained their daughter for Harvard from birth, barraging her with verbal stimuli, subjecting her to a strenuous regime of home study and making her swim long distances. One of the most successful schools at getting students into American Ivy League universities is Raffles Junior College in Singapore.

The talent war is producing a global meritocracy—a group of people nicknamed “Davos men” or “cosmocrats” who are reaping handsome rewards from globalisation. These people inhabit a socio-cultural bubble full of other super-achievers like themselves. They attend world-class universities and business schools, work for global organisations and speak the global language of business.

Countries that still insist on clinging to egalitarianism are paying a heavy price. Sweden, for instance, finds it hard to attract foreign talent. And across Europe, egalitarian universities are losing out to their more elitist American rivals.

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Meritocracy and its discontents

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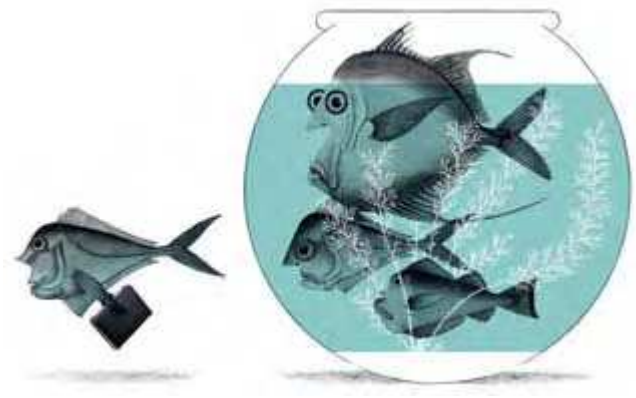

Not everybody is happy with the talent elite

IN “THE RISE OF THE MERITOCRACY”, published in 1958, Michael Young, a British sociologist and Labour Party activist, conjured up an image of a society obsessed with talent. The date was 2034, and psychologists had perfected the art of IQ testing. But far from promoting social harmony, the preoccupation with talent had produced social breakdown. The losers in the talent wars were doubly unhappy, conscious not only that they were failures but that they deserved to be failures. Eventually they revolted against their masters.

The rise of the talent elite has bred resistance, which started on the right. T.S. Eliot, a 20th-century poet and critic, argued that choosing people on the basis of their talents would “disorganise society and debase education”. Edward Welbourne, a Cambridge don, dismissed IQ tests as “devices invented by Jews for the advancement of Jews”. But after the second world war the resistance spread leftward. Leftists argued that meritocracies were not only unpleasant but unjust. If “talent” owed more to nature than nurture, as many social scientists insisted, then rewarding people for talent was tantamount to rewarding them for having privileged parents.

This resistance has occasionally boiled over into outright rebellion. Young's book was an opening shot in a successful war against the 11-plus, a British school examination that divided children between a gifted elite destined for academic grammar schools and those consigned to run-of-the-mill secondary modern schools. The 1960s saw widespread student revolts against selection and elitism.

There are plenty of signs that another backlash is on the way, from John Kerry's complaints about American companies outsourcing jobs to a rash of riots in China. Much of this resentment focuses on growing inequalities. People complain that these are straining the bonds of society to breaking point: a new aristocracy of talent is retreating into golden ghettos and running the global economy in their own interests. “The talented retain many of the vices of aristocracy without its virtues,” said the late Christopher Lasch, an American historian, in one of the best analyses of the trend. The logic of talent wars is meritocratic: the most talented get the most rewards. But the reality of democracy is egalitarian: the people can use their political power to defeat the bell curve.

In some ways things are worse than they were when Young wrote his book. Inequalities are much wider—in both America and China they are returning to early 20th-century levels—and the talent elite has gone global. Young's rebels can now add patriotism (or bigotry) to egalitarianism. Manuel Castells, a sociologist, complains that “elites are cosmopolitan, people are local”. Samuel Huntington, a political scientist, argues that “ a major gap is growing in America between its increasingly denationalised elites and its ‘thank God for America' public.” On American television personalities such as Lou Dobbs and Bill O'Reilly beat the populist drum against those cosmopolitan elites. In China people denounce returning émigrés as “bananas” (yellow on the outside, white inside). Across much of the developing world the

targets of choice for rioters are rich ethnic minorities and foreigners.

But in other ways things have got much better. The number of winners now is much larger than it was in 1958. In Young's day, the meritocrats concentrated on spotting recruits for Oxbridge and the senior civil service. The rest were labelled failures. Since then, America and Europe have created a mass higher education system, and developing countries are determined to follow suit. When Young was writing, China and India were trapped in poverty. Today they are growing so fast that they, too, are suffering from talent shortages.

Moreover, some problems could prove self-correcting. Many talented people not only create jobs and wealth, they turn their hands to philanthropy, as Bill Gates and Warren Buffett have done. The growing returns to education create incentives for people to get themselves educated, producing a better-trained workforce as well as upward mobility. In China families spend more on education than on anything else, despite the one-child policy. Multinational companies routinely promote local talent in the developing world, putting an ever more multi-ethnic face on the global talent elite. Overheated talent markets prompt companies to move production elsewhere—to Mysore rather than Bangalore, say, or Austin, Texas, rather than Silicon Valley.

Above all, there is something appealing about the meritocratic ideal: most people are willing to accept wide inequalities if they are coupled with equality of opportunity. In America, where two-thirds of the population believe that everyone has an equal chance to get ahead, far fewer people favour income redistribution than in Europe.

Growing wealth also means that society can reward a wider range of talents. “I must study politics and war that my sons may have liberty to study mathematics and philosophy,” wrote America's second president, John Adams, and they in turn must study those subjects so that their children can study “painting, poetry, music, architecture, statuary, tapestry, and porcelain”. These days, sports stars and entertainers can make millions. There are also ample rewards for all sorts of specialised talents, from the gift of bringing history to life (all those well-paid TV historians) to the ability to produce a perfect soufflé (the best-paid chef in America, Wolfgang Puck, earned $16m last year). It sometimes seems that there is no talent so recondite that you cannot make a living out of it. Takeru “Tsunami” Kobayashi earns more than $200,000 a year as the world's hot-dog eating champion: he can eat more than 50 in 12 minutes.

Making it palatable

The backlash is not inevitable, then. But it is sensible to take steps to prevent it. One popular answer is affirmative action, an idea that is making headway even in that last redoubt of old-fashioned meritocracy, the French establishment. However, experience in America—which introduced the practice in the 1970s—suggests that it raises a host of problems. In practical terms, many “affirmative-action babies” fail in highly competitive environments. On a more philosophical note, why should the children of rich blacks be given a head start over the children of poor whites? The biggest problem with affirmative action, however, is that it comes too late. The best way to boost the life-chances of poor people is to intervene much earlier in life—to set them on the right path in kindergarten and primary school and reinforce those lessons in secondary school.

Progressive taxation can help. For much of the post-war period most rich countries taxed talent too

heavily, causing bright flight. But today, in America at least, the danger is the opposite. The Bush administration is trying to reduce taxes on both earned income and inherited wealth at a time when the talented are reaping huge rewards: American CEOs earn 300 times more than the average worker. This threatens to turn the children of the rich into playboys and playgirls and widen inequalities to unacceptable levels.

The best way to head off a backlash is to give everybody a fair chance. This means investing in childhood nutrition and pre-school education. It also means repairing the lowest rungs of the educational ladder. Developing countries need to continue the march towards universal primary education: failure to do so will exacerbate skill shortages as well as widen inequalities. Developed countries need to toughen up their schools. In the 1960s too many schools were lowering standards in the name of child-centred education and shifting the emphasis away from science and mathematics. The chief victims of this were underprivileged children who could not rely on their parents to make up for the deficiencies of their schools.

The success of advanced economies is increasingly dependent not on their physical capital but on their capacity to mobilise their citizens' brainpower. The rise of a global meritocracy offers all sorts of benefits, from higher growth in productivity to faster scientific progress. It can boost social mobility and allow all sorts of weird and wonderful talents to bloom. The talent wars may be a source of trepidation for companies and countries. But they should also be a cause for celebration.

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The airliner that fell to earth

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Will politicians shoot down the world's biggest passenger jet?

Reuters

PRIME MINISTERS and heads of state from France, Germany, Britain and Spain were all there to claim credit for a European triumph when the A380 passenger jet was unveiled in January 2005 in a grand ceremony in Toulouse, at the factory where the final assembly of pieces from all over Europe takes place. Barely six months later, while everyone was admiring the plane's first flight, Airbus slipped out news of a six-month delay in deliveries. Then last June it announced a further six-month delay and said it would deliver a mere nine planes in 2007, rather than 25. Heads rolled, both at Airbus and its parent company, EADS: two Frenchmen and the German boss of Airbus lost their jobs.

But new aircraft are often overdue. The first Boeing 747s were two years late in 1969. That delay nearly bankrupted Boeing, however. And this week EADS confirmed rumours that the delay to the A380 had increased to two years and spelled out the financial consequences. Only one aircraft will now be delivered next year. The delay will knock a further €4.8 billion ($6 billion) off profits and €6.3 billion off revenues at EADS between 2006 and 2010.

The bill could yet prove even higher. No one expects the big early customers such as Emirates or Singapore to cancel all their orders, but threatening noises this week from Emirates' boss Tim Clark about “considering all his options” suggest that large-scale compensation and even partial reductions in orders could be in the offing. These airlines and other early customers, such as Qantas, Lufthansa and Virgin Atlantic, have built their growth plans around having large numbers of extra seats available on an aircraft that promises cost-per-seat reductions of 15-20%. They will want Airbus to pay for the leasing of smaller Boeings or Airbuses to plug that gap. All this comes as orders for the new airliner have stuck at around 160: each delay pushes up the number needed for break-even from the original figure of 250.

Looming trouble

The immediate cause of the disaster was a breakdown in the snap-together final assembly process in Toulouse that has served the company well for over 30 years. Rear fuselages made in Hamburg were supposed to arrive in Toulouse with all their wiring ready to plug into the forward parts coming in from factories in north and west France. But the 500km of wiring in the two halves did not match up, causing huge problems. Failure to use the latest three-dimensional modelling software meant nobody anticipated

the effect of using lightweight aluminium wiring rather than copper, which is to make bends in the wiring looms bulkier. Worse, the engineers scrambling to fix the problem did so in different ways. So the early aircraft all have their own one-of-a-kind wiring systems. It will take all of next year to introduce a proper standardised process.

None of this would have mattered so much if the airliner's fuselage had all been built in France. But Germany lobbied hard to land a big chunk of the A380, to add to the final assembly of some derivatives of the A320 family. Now the greater complexity of the super-jumbo has shown up the inherent weaknesses in Airbus's production system, just as it faces a revitalised Boeing and a weaker dollar. Most of Airbus's costs are in euros, but sales are in dollars. So Airbus's new boss, Christian Streiff, must slash costs.

Yet all that emerged this week was the vaguest of outlines of a plan called “Power8” to trim head-office costs and other overheads by 30% and to aim for a 20% improvement in productivity over the next four years, without mass firings. EADS hopes this will save some €5 billion, to plug the cash hole caused by the delays.

That does not go far enough. As Mr Streiff pointed out this week, Airbus must also catch up with Boeing in product development, cutting its lead-time for new aircraft from seven to five years. Boeing is enjoying record sales of its 787 Dreamliner, but Airbus had to go back to the drawing board to redesign its riposte, the A350. EADS has not yet said how much the delayed development of the A350 will cost, but Sash Tusa, an analyst at Goldman Sachs, an investment bank, estimates that it could be more than €2 billion.

For a real solution to its problems, Airbus must take more drastic action, such as doing away with the politically motivated division of labour between German, French, Spanish and British production sites. Mr Tusa says that Airbus, with 16 sites, has seven too many. Two factories in France, four in Germany, and one in Spain could be sold or closed down. And it would make most sense to build all of the A380 in France and all of the A320 in Germany. But both countries want to keep production of the prestigious new jet.

Airbus's relationships with its suppliers is another thorny issue. Boeing has benefited enormously by outsourcing production, but that is a no-go area for Airbus. Yet the combination of Europe's high wages and strong currency means that some of Airbus's production will have to move into countries where the currency is linked to the dollar. Mr Streiff promises to rethink such taboos and present the results of his inquiry early next year. If Airbus does nothing, says Scott Babka, an analyst at Morgan Stanley, an investment bank, its profit margin will be some 4% and it will be destroying capital. The outfit will be competitive only with a margin of around 10%. More alarmist analysts think that doing nothing would kill the company and make Boeing a monopoly producer.

But Mr Streiff's room for manoeuvre is constrained by politics. German politicians are up in arms about rumours that all A380 production will be moved to France; Dominique Strauss-Kahn, a Socialist candidate for the French presidency, has said that rather than slashing costs, Mr Streiff should hire more workers in order to make up for the delays. He regards talk of job cuts as a symptom of rampant capitalism.

To further complicate matters, the German government has not denied that it has plans to buy a stake in EADS when DaimlerChrysler reduces its stake from 22.5% to 15%, as the carmaker plans to do. Rather than engaging in such power struggles, however, the German government should be helping Mr Streiff with his restructuring. French politicians, in the run-up to the presidential election next year, are unlikely to have anything useful to contribute. The fate of Airbus now depends as much on political courage as on managerial expertise.

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Luxury goods

One up for LVMH

Oct 5th 2006 | PARIS
From The Economist print edition

The latest round in the rivalry between two French businessmen

BERNARD ARNAULT was beaming as he announced the establishment of the Louis Vuitton Foundation for Creation on October 2nd at the headquarters of Moët Hennessy Louis Vuitton (LVMH), his big luxury-goods conglomerate. Le cashflow is not enough, he declared. Frank Gehry, the architect who will design the building to house the company's collection of contemporary art and temporary exhibitions, called it a "heavenly assignment". And the mayor of Paris, Bertrand Delanoë, called it "a magnificent gift" for the city.

AP

Frank explains his heavenly cloud to Bernard

Mr Arnault's gesture will console Parisians after the loss of one of Europe's best collections of contemporary art to Venice. Last year François Pinault, Mr Arnault's arch-rival and the former boss of PPR, another big luxury-goods group, abandoned his plan to build a museum for his personal art collection on an island in the River Seine on the outskirts of Paris, after a fight with local bureaucrats. He bought the Palazzo Grassi, a Venetian palace formerly owned by Italy's Fiat group, and moved part of his collection there instead.

Paris's loss is Mr Arnault's gain. Without Mr Pinault's museum the LVMH collection will shine more brightly in the intricate glass edifice resembling a cloud that Mr Gehry is planning to construct at the Jardin d'Acclimatation, a children's park on the northern edge of the Bois de Boulogne. Those who know the two billionaires' respective collections say that Mr Pinault's is richer and more interesting. Art dealers say he has a trained eye and deep knowledge of the market. "A comparison with other initiatives is not pertinent," said Mr Arnault sourly when asked about the failed Pinault plan for Paris.

The rivalry between the two men has become the French equivalent of the epic fight between Aristotle Onassis and Stavros Niarchos, two Greek shipping tycoons. It began in luxury goods with sparring over the takeover of Gucci, an Italian luxury-goods firm, at the beginning of the decade. Mr Pinault won that scrap when LVMH grudgingly sold its minority stake in the firm, albeit at a handsome profit.

Their competition continued in the world of commercial art. After Mr Pinault bought Christie's, a British fine-art auction house, in 1998, Mr Arnault tried to buy Sotheby's, another big auction house. When he failed, he took over Phillips, a smaller auction house, with the aim of breaking the duopoly of Sotheby's and Christie's at the top of the market. Phillips bought market share, mainly by giving sellers lavish

guarantees, promises to buy items at pre-agreed prices if the bidding failed to go high enough. The strategy was successful, but very costly. After losing millions, Mr Arnault sold out of Phillips, though he still owns L'Etude Tajan, the biggest French auction house.

Over the past few years the two men seemed to have agreed on a truce in the luxury-goods business, though LVMH continues its litigation against Morgan Stanley, an American investment bank, over its allegedly favourable treatment of PPR. LVMH claims that between 1999 and 2002, Morgan Stanley was deliberately unfair to LVMH in its equity research. The reason, it says, is that Gucci was one of Morgan's best investment-banking clients, so making LVMH look bad was good for Gucci. Morgan Stanley, which denies Mr Arnault's accusation, helped to take Gucci public in 1995 and then helped it to fend off the takeover bid by LVMH in 1999.

Even so, the ceasefire may not last. PPR recently sold Printemps, a chain of department stores. It is rumoured to be about to sell FNAC, a books and consumer-electronics retailer, and possibly Conforama, a furniture retailer, and Redcats, an American mail-order business. This could herald PPR's transformation from a luxury-and-retail conglomerate into a pure luxury group. Margins are more attractive in the luxury-goods business: LVMH's profits were up 46% in the first half of this year compared with the same period last year, whereas PPR's profits rose by 14.4%.

If PPR were to challenge LVMH more directly, the result would be further tussles over the few remaining independent luxury-goods firms. Armani, Chanel and Hermès are the most coveted, and Armani is the likeliest prey because Giorgio Armani, its boss, is 72 and does not have children or a designated successor. A bidding war between the rivalrous Mr Pinault and Mr Arnault would guarantee Mr Armani a very comfortable retirement indeed.

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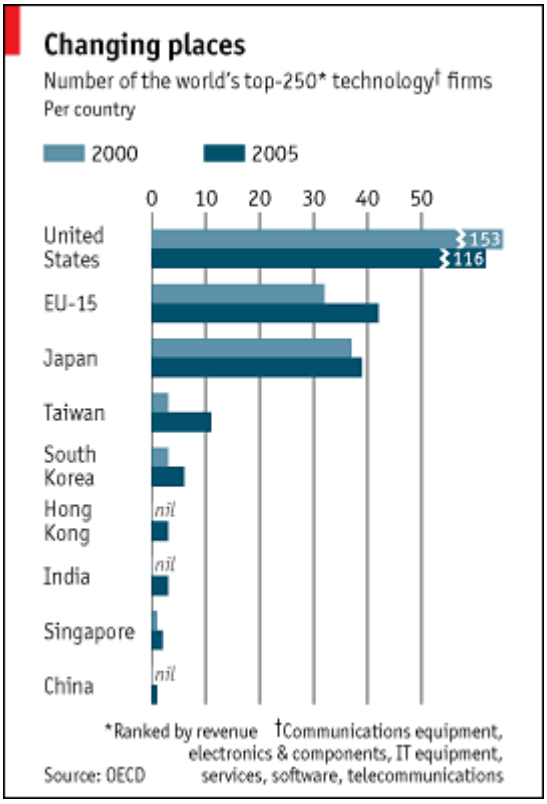
The technology industry

Different strokes

Oct 5th 2006
From The Economist print edition

China and India are emerging as technology titans, but in different ways



THE Dow Jones Industrial Average may have reached levels unseen since 2000 this week, but the technology industry has changed dramatically since the bursting of the internet bubble. The nature of the transformation is apparent in a new report on the state of the industry, released this week by the Organisation for Economic Co-operation and Development (OECD), the club of rich countries. Its league table of the world's 250 largest technology firms, measured by revenue, shows two big shifts. The first is that it includes far fewer hardware and manufacturing firms than it did five years ago, and far more software and service companies. The second is that Asian firms are pushing aside American ones.

Companies from China, Hong Kong and India appear in this year's ranking for the first time and the number from Taiwan more than trebled (see chart). China is actually under-represented in the figures: many of the Hong Kong and Taiwanese firms do the bulk of their business on the mainland and many of the big Western technology firms have substantial operations in China. Indeed, China is now the world's largest exporter of technology goods (although much of the work is on behalf of foreign firms). Domestically, China is now the sixth-biggest buyer of high-tech goods and services in the world; by 2010 it will be in third place, behind America and Japan. Meanwhile, revenue from software and services has increased by around 50% between 2000 and 2005. So it is no surprise to see India's software stalwarts—Tata Consulting Services, Wipro and Infosys—on the list.

For anyone who has choked on the exhaust in Shenzhen or crawled through Bangalore's notorious traffic, all this confirms what has been apparent for years. Yet although China and India are often lumped together as tomorrow's technology titans, there are marked contrasts in their technological development. They have roughly the same population, but China spends 2.5 times as much on technology as India does. It is already the world's largest mobile-phone market, and the second-largest market for PCs. Moreover, at the end of 2005, China had around 110m internet users, compared with 51m in India; and today China has 430m mobile-phone users, versus 120m in India. The two countries are adopting technology at different paces and in different ways.

China's lead is partly the result of co-ordinated government action. Centralised economies can pour resources into projects and direct the development of entire industries, something that is much harder in India's sprawling, bureaucratic democracy. For mobile phones, China established a second state-owned operator to challenge the incumbent, while India's operators remained tangled up for years in legal fights over a botched regulatory framework. China has also tried to develop its own technical standards so that it can avoid paying royalties to foreign firms for using intellectual property.

A further difference is that China's manufacturing strength means high-tech gear is available locally at low cost, whereas India must import it, explains Sacha Wunsch-Vincent of the OECD, who helped write the report. India has focused more on software and services, which can be delivered via networks without bureaucratic interference, unlike physical goods. But both Chinese and Indian firms are now setting up shop in central and eastern Europe, as a low-cost stepping-stone towards European Union

countries, notes Mr Wunsch-Vincent.

Another striking finding is that although revenues and R&D spending are around 20% higher than in 2000 among the top 250 global technology firms, the level of employment is lower. Does that mean more automation is putting people, even in the most advanced industries, out of a job? Probably not. Instead of implying that the human-capital intensity of the technology industry has declined, the opposite is more likely: companies are increasingly outsourcing their operations to smaller, specialist firms—many of them in China, India and Taiwan, as well as in the West—that do not appear in the top 250. As a result, the rise of Asia is best characterised as the welding of the region into the global technology supply chain, in a way that benefits firms in other parts of the world as well.

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Corporate scandals

The fugitive

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More twists in the fuss over options backdating

AFTER earlier speculation that he was hiding out in Sri Lanka, Kobi Alexander, the founder and former boss of Comverse Technology, a software firm, seems to have chosen Namibia as his refuge. Mr Alexander is the highest-profile executive to be charged so far in the scandal surrounding the backdating of executive share options at over 100 American firms. When fraud charges were filed in August against Mr Alexander and two other former executives—all three had resigned in May—it emerged that he was on the run, and had transferred $57m to his native Israel in what prosecutors called a “money-laundering scheme”.

Namibia's efforts to stop money laundering detected an unusually large influx of money, which alerted the authorities to Mr Alexander's presence in the country, where he had been living openly with his wife and children. The entrepreneur, a pioneer of Israel's booming technology industry, was arrested on September 27th while lunching with his wife at home. On October 3rd he was freed on bail, pending a court hearing on America's efforts to extradite him. Namibia does not have an extradition treaty with America.

Mr Alexander and his former colleagues are accused of backdating share options to value them at low points in Comverse's share price. They benefited personally from this and also used such options to reward employees. They are also accused of running a secret slush fund of options allocated to fictitious employees, which could later be transferred to real ones. (If that sounds odd, Cablevision, another firm caught up in the scandal, reportedly gave options retrospectively to an executive after his death.) These options were not counted as a cost when calculating profits, as they should have been—hence the fraud allegations. This week Apple said its boss, Steve Jobs, had known about backdating at his firm but had been unaware of the accounting implications.

As firms struggle to restate their accounts, hedge funds are buying their bonds. The funds are speculating that by failing to file in time they would violate covenants, thereby requiring repayment of the bonds at full face value. Which raises the question of whether the punishment will be worse than the crime for backdating's main victims: shareholders. Holders of Comverse shares, for example, now hold paper worth around one-quarter less than it was in March.

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Amazon

Lifting the bonnet

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The e-commerce giant wants to be more than just a retailer

WHAT kind of company is Amazon.com? It is usually described as an internet retailer. But it has fingers in many other pies, too. There is A9, its search engine, and Unbox, a video-download service. It operates online stores for other firms, such as Target. It was a pioneer in developing "collaborative filtering" software to make recommendations to shoppers. And last week Jeff Bezos, Amazon's boss, was out stumping for three of its "utility computing" offerings: Simple Storage Service (S3), which provides cheap access to online storage; Elastic Compute Cloud, which lets programmers rent computing capacity on Amazon's systems; and Mechanical Turk, which connects firms with people who perform small tasks that are difficult to automate. When Mr Bezos talks about these services his firm no longer sounds like a retailer at all.

In order to cope with the Christmas rush, Amazon has far more computing capacity than it needs for most of the year. As much as 90% of it is idle at times. Renting out pieces of that network to other businesses, such as SmugMug, an online photo site that uses the S3 service, is a way to get extra return on Amazon's $2 billion investment in technology. Amazon is renting out its physical infrastructure too. Last month it announced Fulfillment by Amazon, which allows other firms to use Amazon's staff and warehouse space to send out goods and handle returned items. It also introduced WebStore by Amazon, which provides access to all of Amazon's back-end technology, including the ability to offer third-party products.

Yet shouldn't the retailer stick to its knitting? Ah, but all this technology "is the knitting", insists Mr Bezos. "This is what we've been doing for 11 years. The only thing that's changed is that we're exposing it for others." It might be more accurate, in other words, to start thinking of Amazon not as a retailer so much as a technology and logistics firm.

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Metals and mining

The thrill of the chase

Oct 5th 2006
From The Economist print edition

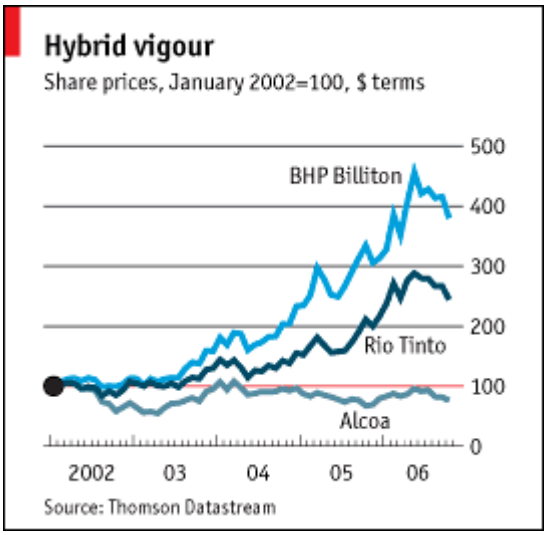
How to make sense of the current plethora of mining deals

"HUNTER or hunted"—that is how analysts at Citigroup, among other banks, classify big metals and mining firms these days. It is easy to see why: so far this year, the predators of the mining world have snapped up two big gold miners and two firms that mainly mine nickel—the latter pair snatched from the jaws of other prowlers. Mittal has devoured Arcelor to become the world's biggest steelmaker; Rusal, a Russian aluminium firm, is said to be on the verge of creating a similar giant by swallowing Sual, a smaller Russian rival, and the aluminium businesses of Glencore, a Swiss company; and India's Tata says it is thinking about buying Corus, an Anglo-Dutch firm. The shared bloodlust, however, disguises two conflicting strategies, between firms that are trying to become the biggest producers of a particular metal and those that aim for diversity.

In part, this dichotomy reflects the peculiarities of steel- and aluminium-making, in which firms tend to process raw materials bought from mining firms (bauxite or alumina for aluminium, and iron ore and coking coal for steel), rather than dig them up themselves. So one rationale behind steel and aluminium mergers is to gain more leverage over suppliers. This is particularly important for steelmakers, since just three firms control three-quarters of the world's supply of iron ore and set prices by negotiation with their customers. To escape this trap, firms such as Mittal are acquiring mines of their own. Similarly, Sual's bauxite reserves and Glencore's alumina refineries make a good match for Rusal's aluminium smelters.

But in the long run, reports suggest, Rusal's bosses also want to expand into other metals. After all, the shares of big aluminium firms, such as Alcoa, have idled in recent years, even as those of mining conglomerates have raced ahead (see chart). Shares of the most diversified, such as Rio Tinto and BHP Billiton, trade at higher valuations than those of their less variegated rivals. The more commodities a mining firm churns out, the less its profits depend on the price of each one. Likewise, the more countries it operates in, and the more mines it runs, the less vulnerable it is to problems in any one of them.

This hedging effect is all the more important for firms seeking to expand beyond their bases in stable places such as North America and Australia to dodgier jurisdictions in Africa and Latin America. As commodity prices have risen, governments in some poor countries have demanded higher royalties or threatened recalcitrant firms with expropriations. But these countries contain the most promising territory for exploration, so such political risks can only increase.



No wonder that Companhia Vale do Rio Doce, a big Brazilian iron-ore producer, is buying Inco, one of the two Canadian nickel firms gobbled up in recent deals. The output of the other, Falconbridge, complements the coal, copper and zinc businesses of its purchaser, Xstrata.

But not all diversification is popular with investors. Earlier this year, the shareholders of Inco and Falconbridge rejected a three-way tie-up with Phelps Dodge, an American copper miner. The resulting firm would have been a top producer of copper and nickel, two of the most lucrative metals of late, but also among the most volatile. Conversely, says Fraser Phillips of RBC Capital Markets, a Canadian bank, firms that sell commodities with more stable prices, such as iron ore and coking coal, trade at a premium.

Lumping gold in with other metals is another no-no. Since their product is so prized, gold miners tend to trade at even higher valuations than diversified mining firms. So gold firms tend to sell off seams of any other metals they discover, and to merge only with one another. Meanwhile, the managers of Anglo-American, a mining conglomerate, have decided they will make their shareholders more money by selling their stake in AngloGold Ashanti, a big gold miner, than by keeping hold of it.

Another worry is that predators will pay too much for their prey. The prices of most metals have risen dramatically over the past few years and many are still far above the cost of production, despite falling somewhat in recent months. Gloomy economists see that as a sign that supply will inevitably expand, pushing prices down further. But commodities firms of all stripes argue that rapid economic growth in the developing world will boost demand for their wares for years to come and so help them to escape from the industry's typical boom-and-bust cycles.

Furthermore, since new mines can take as long as a decade to develop, mining executives say, and since firms made few investments during the lean years of the 1980s and 1990s, supply could take a long time to catch up with demand. Indeed, current efforts to expand output are being hampered by a shortage of all manner of inputs, from trucks to geologists.

Given this promising outlook, mining bosses feel that their firms' share prices have not risen as high as they should, says Michael Gambardella of JPMorgan. That makes share buybacks and purchases of other seemingly undervalued firms look like good deals. Moreover, thanks to high commodity prices, mining firms are flush with cash. Analysts at Goldman Sachs calculate that the four biggest will have over $15 billion to spare next year, after dividends and capital expenditure. However, Heath Jansen of Citigroup points out that the best time for diversified firms to take over their more specialised rivals is when commodity prices fall. The conglomerates' revenues and share prices should hold up better than those of other mining firms, allowing them to buy struggling firms at a discount—provided, of course, that they can keep their hunger at bay until then.

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The car industry

Not playing

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GM decides to break off talks with Renault and Nissan

IT'S all off. On October 4th General Motors (GM), a struggling American car giant, said it had broken off negotiations with Renault and Nissan about joining their alliance. The idea of such a tie-up, which would have formed a global car group nearly twice the size of its nearest rival, was first floated by Kirk Kerkorian, a billionaire who is GM's largest individual shareholder. GM's boss, Rick Wagoner, said the company's board had unanimously determined that "the proposed alliance was not in the best interests of GM and its shareholders."

That is not to say that there were no potential benefits in an alliance, said Mr Wagoner, but Carlos Ghosn (pictured), the boss of both Nissan and Renault, had proposed an all-or-nothing approach based on close co-operation and cross-holdings of shares, which would have restricted GM's ability to form alliances with other partners. Mr Wagoner insisted that such an alliance would "in fact, slow us down," and serve as a distraction from GM's turnaround efforts.

Reuters

Can the wizard enchant Ford instead?

Things have indeed changed markedly since Mr Kerkorian sprung the idea of an alliance in late June. At the time, everything seemed to be going wrong for GM: sales were collapsing and a potential strike loomed at Delphi, its former parts unit and still one of its biggest suppliers. But even as alliance talks began, things started to improve. Sales picked up, as did GM's share price, which is now up about 70% for the year. That is not to say there are not still serious problems, Mr Wagoner acknowledged at a press conference this week, but GM's board, including Mr Kerkorian's representative, Jerry York, could not see any answers in an alliance.

The decision is a setback for Mr Kerkorian, who recently announced plans to increase his stake in GM. But it is perhaps even more of a blow for Mr Ghosn. Long seen as the car industry's most impressive wizard, his image has been harmed by problems at both Renault and Nissan. He may now look for a different American partner. The obvious candidate is Ford, which is in deeper trouble than GM. A few weeks ago its executive chairman, Bill Ford, hinted at his interest in talking to Mr Ghosn.

But things have since changed at Ford, too. Its new boss, Alan Mulally, who took over this week, might veto the idea. Mr Mulally, a former Boeing executive, is not the sort to march to someone else's orders, be it Mr Ford or Mr Ghosn. But considering the depth of its problems, Ford may find synergies where GM found only distractions.

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Face value

The cutting edge

Oct 5th 2006
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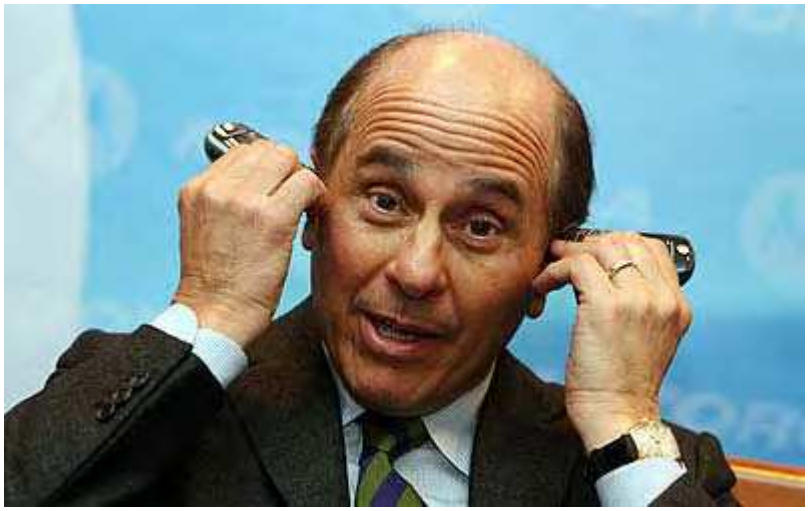
Landov



Ed Zander, Motorola's boss, is combining slim mobile phones with big bets

ONE of the first things that Ed Zander told Motorola's executives, after joining the electronics giant as its new chief in January 2004, was to forget about Iridium—an ambitious satellite-communications project, launched in 1998, which had gone bankrupt within months. Its failure put an enduring dent in the firm's confidence, and seemed to epitomise a company that had lots of technological prowess but was unable to exploit it fully. Mr Zander felt it was important that Motorola's people did not learn the wrong lesson from the Iridium episode. His message to them, he says, was simple: “Don't be hard on yourself—you took a risk.” And encouraging risk-taking has been Mr Zander's main aim ever since.

Less than three years later, there are few reasons for anyone to be hard on Motorola, which has not merely found its feet again under Mr Zander's leadership, but now has a spring in its step. The most obvious symbol of the firm's rebound is the slim and hugely popular RAZR (pronounced “razor”) phone, sales of which now exceed 50m. Launched in late 2004, it is the only mobile handset to have come close to attaining the iconic status of the iPod or the BlackBerry. The RAZR project was already under way when the 59-year-old Mr Zander arrived. But company executives credit him with championing the phone, both internally and externally. “He got this party started,” says Richard Nottenburg, Motorola's chief of strategy.

Since then, other handsets have demonstrated that the success of the RAZR was no mere fluke. These include the SLVR (“sliver”)—which offers a slim “candy bar”-shaped alternative to the RAZR's clamshell design—the KRZR (“crazer”), a narrower version of the RAZRthat went on sale in America last week, and the Q, an e-mail-friendly smartphone that is much slimmer than the BlackBerry or the Palm Treo. Having lost the position of market leader to Nokia in 1998, Motorola's handset division is now catching up again. Handset revenue, at $25.7 billion over the past year, is still one-third lower than at Nokia, but Nokia had a two-to-one lead in revenue just two years ago. Motorola has also narrowed the profitability gap sharply: Per Lindberg, an analyst at Dresdner Kleinwort, reckons that Nokia's handset margins have fallen by five percentage points since mid-2004, whereas Motorola's have increased by three percentage points.

Indeed, its handsets have been so successful that other rivals have scrambled to copy them. South Korea's Samsung, the industry's number three, nicknamed its RAZR knock-off the “Blade”; Japan's Sanyo calls its version the “Katana” (after a Japanese sword). Motorola's next move is a new range of phones

called SCPL (“scalpel”), the first of which will be a low-cost, slimline phone aimed at customers in the developing world. But Mr Zander is betting that Motorola's new-found appetite for risk-taking and innovation will continue to give it the edge.

Risk-taking does not just mean placing big strategic bets with long-term pay-offs, however. Success turns just as much on the willingness of people throughout a company to take all the little risks that add up to good execution. One of the biggest changes at Motorola since Mr Zander's arrival, says Jim Wicks, who heads the firm's “consumer experience design” group, has been in the way that different teams—from design and engineering to marketing and finance—have got together to sort out the enormous complexities involved in developing new handsets. Co-operation improved, says Mr Wicks, because each group became willing to try something difficult that might help the others—without worrying too much about who would get blamed if they failed.

That sort of atmosphere is hard to achieve unless the boss takes it seriously—and unless everyone in the company knows that the rules really have changed. By encouraging Motorola's people to push themselves in this way, Mr Zander has changed the company's frame of mind. The new corporate culture has also filtered through to the company's hiring, where more emphasis is now placed on people skills, rather than just technical ability. After all, when innovation involves complex interactions between many internal teams and outside partners—as it does at Motorola—the ability to communicate is prized.

Sharpr than evr

As well as encouraging those beneath him to take small tactical risks, Mr Zander is also placing large strategic bets of his own. The guiding principle is what Motorola calls “seamless mobility” or “über-mobility”. The idea is that new communications technologies will allow people to be more flexible in their use of digital content, from music and video to e-mail and phone calls, so that they can access whatever they want, whether they are at home, in the office, or out and about. This calls for a further shift from fixed-line to wireless technology, an area where Motorola excels, that will be as disruptive as the shift from radio to television was. “This is the new radio,” says Mr Zander, grabbing a local-area-network cable from the conference table, “and the new television is air.” Last month Mr Zander made one of Motorola's biggest acquisitions in years, agreeing to pay $3.9 billion for Symbol, a maker of wireless hand-held scanners, to strengthen the workplace part of this strategy.

But Motorola's two biggest long-term bets, says Mr Zander, are on IPTV, which will supply television services over broadband internet links, something telecoms operators around the world are starting to adopt; and WiMax, an emerging wireless standard that will link mobile devices to the internet at broadband speeds. Motorola's embrace of WiMax is surprising, since it is widely seen as a challenger to existing mobile-phone technologies. If these investments do not pay off, investors may not be as forgiving of failure as Mr Zander professes to be towards his employees. But the steady stream of sharp new handsets should keep them happy in the meantime.

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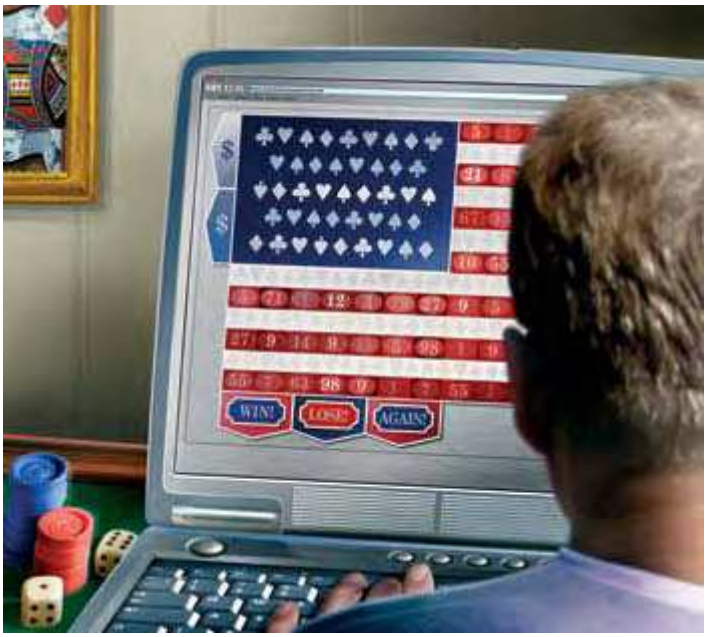
About sponsorship

Online gambling

Busted flush

Oct 5th 2006
From The Economist print edition

Although America's effort to prevent online gambling has brought the industry to its knees, it may yet end up having to legalise and regulate it



FORTUNE may well favour the brave, but in America it increasingly leans towards the foolhardy, reckless and criminal. On September 30th Congress rushed through a bill to stop banks and credit-card companies from processing payments to online gambling companies.

The bill, tacked onto legislation tightening port security, could be signed into law shortly by George Bush. It is aimed at choking off the flow of American funds to a fast-growing, if illegal, industry that took some $12 billion in bets worldwide last year, half of which are thought to have been placed by Americans.

The immediate effect was to send an entire industry into a spin as the share prices of online gambling firms crashed. Many now plan to concentrate on European and Asian gamblers. But America's actions are unlikely to produce the results desired by politicians. Online gambling seems unstoppable and prohibition can be easily circumvented. This could drive online gambling into darker and more dangerous corners for Americans, even as punters in other countries are protected.

The American Gaming Association, which represents the big casino groups, reckons some 4% of Americans, or about 12m people, gambled online last year. That does not seem like many when one in four Americans visited offline casinos. But the number of Americans gambling online has doubled over the past year. Some studies suggest that a quarter of male college students now play card games online at least once a month.

This burgeoning American love of internet gambling fuelled the industry. The first online casinos started taking bets in the mid-1990s and by 1999 estimates suggested there were over 400 gambling websites. It could now be 3,000.

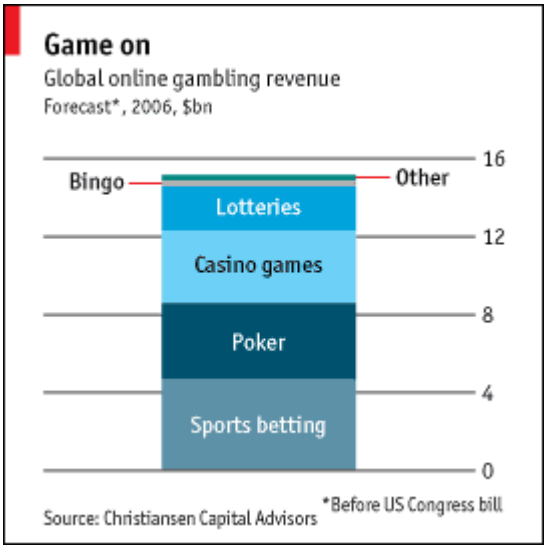
PartyGaming, the biggest by market value, was founded in 1997 by Ruth Parasol, an American lawyer with a colourful business background. The firm took off in 2002 after it developed proprietary software

that allowed punters to play poker with each other over the internet. Poker was the big breakthrough for internet gambling. The game lends itself perfectly to the spread of the internet. In much the same way that eBay found success from the networking effects of matching lots of buyers and sellers of used goods, poker sites were able to match players wanting a game at any time of the day or night.

Fish in the bathtub

The big online sites used obtrusive marketing to push playing online, while taking a cut of the pot. And the popularity of poker soared with televised events and celebrity tournaments. Participants, meanwhile, became some of the industry's best marketers. Some competed to be the most daring or outrageous by posting photographs on the web of themselves playing poker in strange settings; up mountains, in the bathtub or in the back of university lecture halls during classes.

And because this was a game of skill, rather than one dependent on the random generation of numbers, many players fancied they could make a living fleecing cash from those less adept. In some cases they did. Tales abound of experts in game theory leaving university maths departments to make their fortunes online, inspiring legions of amateurs (called “fish” by the more experienced players) to try their luck. In no time at all poker has grown into one of the most popular forms of online gambling (see chart).



PartyGaming, and its rivals, such as Cassava Corp's 888.com and Sportingbet, snapped up smaller firms and also began to offer casino-style games, such as blackjack and roulette. PartyGaming went from making a slim profit of $5m in 2002 to a whopping $293m in 2005 as its revenues approached $1 billion. In June 2005 it listed on the London Stock Exchange, which put a value of £4.6 billion ($8.4 billion) on the firm. Given such companies' warnings that their main business involved breaking American laws, the brokers who listed the firms and the institutional fund managers who bought their shares now face some rather difficult questions.

The great reliance on America left the online gambling firms vulnerable to the legal uncertainty there. The big firms kept their computer servers and head offices far away from any American jurisdiction. PartyGaming and 888.com have their headquarters in Gibraltar, a European off-shore tax haven. Sportingbet moved from the Channel Islands to London in 2002 after the British government cut betting taxes. In exchange some of the big betting firms agreed to move to London under the watchful eyes of regulators and tax collectors. Next year Britain plans to go a step further and legalise online casinos, bringing them into the tax net in exchange for the respectability to be gained from being tightly regulated in a credible jurisdiction.

But as Britain's attitude has become more permissive, America's has hardened. American prosecutors have long taken action against firms that take bets on sports, a form of gambling that plainly contravenes anti-racketeering laws passed in 1961. In more recent years they have used this legislation against American internet betting businesses, including firms that sought to evade the law by operating in countries such as Costa Rica. In August 2000 Jay Cohen, an American, was sentenced by a federal court to 21 months in prison for accepting sporting bets from Americans, even though his operations were overseas.

One consequence was that much of the online gambling business moved to firms such as Sportingbet and PartyGaming that have no American operations. But the limits to that strategy became apparent in July when American federal prosecutors took aim at online gambling sites.

David Carruthers, the British chief executive of BetonSports, which is also listed in London, was detained while changing planes in Texas en route between the company's offices in London and its base in Costa Rica. He was charged with conspiracy and fraud relating to online gambling. One arrest in such an industry might be deemed bad luck, but two in quick succession looked like a losing streak.

Peter Dicks, the British non-executive chairman of Sportingbet, was arrested after arriving in America in September. Louisiana, which outlaws “gambling by computer”, had issued a warrant for his arrest and

promised to nab other managers too if they came within reach. Mr Dicks was detained in New York, but scored a minor victory when his extradition to Louisiana failed on a technicality.

Problems loomed in Europe, too. In August several German states told Bwin, an Austrian internet gambling firm, to cease operations in an effort to maintain gambling monopolies. This was followed by the arrests in September of two of its bosses in France, which also maintains a monopoly over gambling.

Turning off the money

If the American arrests were intended to deter, they quickly achieved their goal. BetonSports stopped taking bets from Americans, as did William Hill, Britain's second-largest bookmaker, which barred players with American credit cards or addresses. The new bill aims to choke off the payment systems, although in many respects it is largely symbolic. “This does not affect the question of whether internet gambling is illegal,” says John Carroll, of Clifford Chance, a law firm. “It is plainly illegal. This law merely puts another weapon in the prosecutors' arsenal.”

Most large credit-card companies already refuse to process online gambling payments, not because of high-minded morality, but because customers can legally renege on gambling debts. And many intermediaries have already abandoned this market, some in the face of prosecution. In 2003 PayPal, an online payments firm owned by eBay, paid a $10m fine to settle such allegations.

Still, gamblers and those who service them are a wily lot and are by definition risk takers. Previous efforts to stop the flow of money to gambling sites did little more than divert it, creating a new offshore industry of financial intermediaries beyond the reach of American legislators.

One such firm is Neteller, a company based in the Isle of Man, a tax-haven in the Irish Sea. Neteller takes credit-card payments or bank transfers from its customers who can then use these to pay their gambling bills. Demand for its services has been booming. Last year it processed some $7.3 billion in online payments. In just the first six months of this year it processed more than $5 billion in payments, most of which are from gamblers in America.

Blocking American users is not hard because gambling sites can know with a fair degree of accuracy the geographic location of users from their internet protocol addresses, the unique numbers assigned to people online. It was the rationale behind a French court's decision in 2000 to require Yahoo! to block French users from part of its site that auctioned Nazi memorabilia, which is illegal in that country.

But it is harder to get banks to stop determined gamblers from using their money to pay online firms. The most glaring gap in the law is that it is based on the fiction that most payments are made using credit-card systems, which can easily identify where payments are going using existing merchant and transaction codes. Although banks can use these codes to identify online gambling firms and their intermediaries, they cannot readily do the same for other sorts of transactions, many of which are likely to be exempted from the final regulations.

“Banks have no way now of reading who the payee is on paper cheques,” according to Nelson Rose, a gambling expert at the Whittier Law School in California. “Banks tried to defeat this bill, not because they cared about patrons' privacy, but because they knew that it would cost them billions of dollars to set up systems to read paper cheques.”

Staying out of jail

Even if the new legislation is largely symbolic, it proved enough to cripple an industry already reeling from the earlier arrests. PartyGaming, which generates nearly 80% of its revenue from America, said it would suspend gambling for Americans. Its shares tumbled by almost 60% overnight. Sportingbet, which makes 60% of its gross profit in America, said its business could be affected if financial intermediaries declined to take deposits from American customers. Neteller, meanwhile, gave warning that the legislation would have a “material adverse effect” on its business. “This law has a tremendous chilling effect,” says Ed Morse, a law professor at Creighton University. “White-collar executives don't want to go to jail.”

In prompting a rush for the exits by the most visible—and arguably the best behaved—online gambling

operators, the law seems instead to have cleared the field for dodgy operators. “You will quickly see a flight of gamblers to unregulated sites,” says Leighton Williams, head of the betting research unit at Britain's Nottingham Business School. “I can't see it having a big effect in stopping gambling.”

Even America's casinos, which long campaigned for the prohibition of online gambling for fear it would cannibalise their business, have begun to lean towards legalisation because they see attempts at prohibition as futile. Many now think that online offerings may help them attract customers. That realisation seems to be reflected in the valuations of American casinos: a group of private equity investors is offering just over $15 billion to buy Harrah's, the world's largest casino operator.

One of the more ironic consequences of the new law is that it may have made British-based online gambling companies vulnerable to takeover by America's casino groups. Not only have the firms' share prices fallen heavily, but their withdrawal from the United States has legitimised them as prey to American operators seeking to quickly obtain online expertise and knowledge of overseas markets.

If such acquisitions come to pass, it seems more than likely that American online gambling firms would begin to lobby American politicians to legalise online gambling. Thus, America's prohibition may ultimately have the unexpected consequence of moving the country one step closer to legalising online gambling.

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The euro area's economy

Feeling fitter

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This year the euro area's economic strength has been a source of surprise. Its longer-term prospects may be brightening too

A MONTH ago Jean-Claude Trichet gave what markets see as his standard nod and wink: the European Central Bank (ECB), said its president, would continue to exercise “vigilance” against inflationary pressures. Stand by, in other words, for another increase in interest rates at the bank's next rate-setting meeting on October 5th. ECB-watchers were therefore well prepared when rates duly rose, by a quarter of a percentage point, to 3.25%.

A slide in consumer-price inflation to 1.8% last month, greased by weaker oil prices, raised no doubts, even though this is at last “below, but close to, 2%”, the ECB's stated aim. Indeed, with real rates not much more than 1% even now, the ECB looks sure to put rates up again this year and is likely to carry on in 2007.

The euro area's economy has looked remarkably healthy this year, and keeps surprising forecasters. In *The Economist*'s monthly poll (see article), the average prediction for GDP growth in 2006 is now 2.5%, up by 0.2 percentage points since last month and by a full point since a year ago. Admittedly, the pace has probably slowed a little since the cracking second quarter, when GDP rose by 0.9%. But the third quarter, which has just ended, was probably more than decent—judging, for instance, by retail sales figures and purchasing managers' indices for both manufacturing and services, published this week.

The question now is whether this year, set to be the best since 2000, heralds a pick-up in the zone's long-term growth rate—limited in recent years, by most estimates, to 2% or so—or merely marks the top of the cycle. Though it is too soon to tell, there are reasons to be cheerful. For a long time, the euro area has needed two things: first, that more of its people work; second, that their productivity (ie, output per hour) rises faster. On both counts, there are signs of improvement.

Take the labour market. At 7.9%, the euro zone's unemployment rate is roughly where it was at the peak of the last cycle, in late 2000. By now, on past form, wage pressures should be starting to burst through. But although wage costs have picked up a bit this year, their growth rate is still subdued—maybe 2.3% or 2.4% in the year to the second quarter, depending on your measure. The thought that jobs may go to central and eastern Europe, or to China, is having an effect.

It seems plain that the zone's NAIRU, the unemployment rate consistent with stable inflation, has fallen. Economists at the European Commission now put it at around 8%, one percentage point less than in 1997 (though well above America's 5%). By that estimate, the jobless rate is at its limit. But it may be too conservative, given that wage growth is not exactly resurgent. The NAIRU is virtually unknowable unless wages start to take off, something that a watchful ECB is unlikely to allow.

Better still, as the commission pointed out this week in its quarterly report on the euro area, the unemployment rate has fallen even though labour supply has been increasing—by about 1% a year since the late 1990s. Perhaps most encouraging is the increase in the proportion of people aged 55 to 64—a group that many European countries have been too eager to pension off—in work or seeking it, from 37.5% in 2000 to 43.7% last year.

On productivity, there are also encouraging early signs. Eric Chaney, an economist at Morgan Stanley, reckons that output per hour in the euro area grew at an annual rate of 2.6% in the first half of this year—twice the pace of 2000-05, the first six years of the single currency's life. He has to make estimates, because not all the official numbers are out, but his reasoning squares with French data showing hourly output rising at an annual rate of 3% .

Start with GDP, which rose at an annual rate of 3.4%. For GDP per worker, deduct employment growth of 1.1%, from data for France, Germany and Spain, three of the top four economies in the club. Then adjust for hours per worker, which have been declining, largely because of the recent rise of part-time employment. Because firms are probably trying to get more hours out of the existing workforce before hiring new staff, Mr Chaney supposes a slower decline than in recent years: 0.3%, against 0.9% in 2002 and 0.5% in 2004.

For the whole year, Mr Chaney forecasts that output per hour will grow by 2.1%. Is this purely cyclical, or will some of the extra growth endure? “You can't say for sure,” he says, “but you get a feeling this is more than cyclical.” Above all, he thinks, European firms are beginning to reap the benefits from investing in information technology, something that America has exploited to far greater effect than Europe has (see article).

Despite all this, euro-area optimists may face a testing few months. It is not hard to see demand growth being dragged down at the start of next year by a planned rise in value-added tax in Germany and budgetary tightening in Italy.

That said, some other possible sources of trouble may be less threatening than they now seem. America's slowdown, though hardly welcome, is one such: Europe's main source of pulling power these days is domestic demand. Oil prices may climb again, but the euro area weathered the recent spike fairly well and should get back a good slice of any extra it spends on energy imports. According to the commission's report, in 2000-05 oil exporters spent a bigger share of each extra dollar of export revenues on imports from the euro zone than they did in 1973-81. The euro area's exports to oil producers rose by 17% last year, adding 0.3% to GDP. The commission expects a further increase in 2006.

A healthier euro zone, of course, should be food for thought for the ECB. In the long run, theory suggests that higher growth, other things equal, should mean higher interest rates for a given rate of inflation. In the shorter term, increased capacity, especially if demand slows, may lean against higher rates—but it is hard to see the central bank relaxing its vigilance just yet.

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About sponsorship

Buttonwood

Instant returns

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From The Economist print edition

Why investors have become addicted to the carry trade

IT IS very hard for people to resist instant gratification. That explains why the carry trade, borrowing at a low rate to buy high-yielding investments, is so common today. It offers immediate rewards.

Because Japanese interest rates are a lowly 0.25%, the yen is widely assumed to be the basis for many carry trades. But, as Tim Lee of pi Economics, a consultancy, points out, the practice is much more widespread; in eastern Europe, many companies and individuals borrow at a lower rate in foreign currencies in order to buy property.

It is a bit like “maxing out” on your credit cards. The reward arrives immediately while sometimes it seems the bill can be indefinitely postponed. But, alas, payment will eventually come due.

The carry trade is essentially a bet on lower volatility. To take an outright gamble that markets will barely move, an investor would write (sell) options; this approach would bring in premium income, but would lose money if prices changed enough for the options to be worth exercising. In the foreign-exchange version of the carry trade, an investor receives an income by borrowing a low interest rate currency and owning a higher-yielding one. This produces a positive return most months, but the risk is that the high-rate currency will devalue, resulting in a heavy loss.

Cynics have described these bets as “picking up nickels in front of steamrollers”. A long series of small gains is punctuated by the occasional wipe-out. However, from the point of view of a hedge-fund manager, it is a perfectly rational approach.

Amaranth Advisors, the hedge fund that lost a bundle speculating on natural-gas futures, is not a typical example of the modern hedge fund. These days, hedge funds like to market themselves as a way to diversify pension-fund (and other institutional) portfolios. That requires them to produce nice, smooth returns that can be plugged into the models of investment consultants. Carry trades fit the bill.

In contrast, betting against the carry looks a far less attractive business proposition. Such a strategy would lose money most months, only to make big gains when devaluation (or a sudden burst of volatility) occurred. That kind of return would look very “risky”, even though the long-term net result would probably be identical to that produced by the carry trade (Nassim Taleb, author of “Fooled by Randomness”, argues the returns would be greater because the likelihood of extreme events is underestimated).

As a consequence, investors tend to switch to a “negative-carry” approach only when the trend is already moving in that direction. In theory, this could lead to very sharp reverses in trend once the carry trade starts to deteriorate.

Fortunately for carry-trade investors, volatility has been very low in the past couple of years. A recent Bank for International Settlements paper* tries to explain why. Part of the explanation may be the lower volatility of economic fundamentals such as inflation and GDP growth; another part results from the improvement in corporate profits and balance sheets; a further part from the greater transparency of monetary policy; and a final part from innovation in financial markets, notably the growth of hedge funds (which have improved liquidity) and the development of derivatives (which have allowed risk to be spread more widely).

Are any of these developments permanent rather than cyclical? Volatility tends to be highest when recessions occur and, although the business cycle has been extended, it has not been abolished. An

economic downturn would also hit companies. And it is easier for monetary policy to be transparent and for central banks to seem all-knowing when economic conditions are benign; much harder when (as globally in the 1970s or in Japan in the 1990s) times are hard. Even the liquidity of financial markets tends to deteriorate when money is tight and asset prices are falling.

But the important point is that financial markets are a complex adaptive system, in which the actions of participants affect the fundamentals. The best analogy might be the “seat belt” attitude to risk. In theory, having seat belts in cars should save lives. But the presence of seat belts may cause motorists to drive faster, leading to no improvement in road safety. That has led some to theorise that people have a mental budget for risk; if it is reduced in one area, they will compensate by taking more risk in another.

Thus the low level of volatility may make investors overconfident, taking on more risk either by buying exotic investments or by using debt to finance their positions. When bad news does occur, those investors will be dangerously exposed. Low volatility and the carry trade sow the seeds of their own destruction.

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* “The recent behaviour of financial market volatility”. *BIS* Paper No. 29, August 2006.

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Wall Street

An old dog barks

Oct 5th 2006 | LONDON AND NEW YORK
From The Economist print edition

It's not yet "Dow 36,000", but are large-cap shares finally reviving?

DO NOT uncork the champagne but it may be worth cracking open a beer. Helped by falling oil prices, the Dow Jones Industrial Average reached record highs this week, the latest sign that investor sentiment is recovering from the bear market of 2000-02. But there is still a long way to go; the much broader S&P 500 index is 12% below its peak, and the NASDAQ composite is less than half its high.

The Dow is a relic of a market indicator; an average, not an index, weighted by price, not by market value. One of the biggest factors behind the Dow's surge has been the revival of Caterpillar, a construction-equipment maker, which just happens to have a higher share price than many larger companies.

But perhaps the resurgence of the Dow is nevertheless revealing a shift in the structure of the stockmarket. Larger American shares are finally making a comeback. And so have they elsewhere in the world over the past month.

Smaller shares have held sway ever since the bursting of the dotcom bubble. The Dow Jones Wilshire Small Cap index reached its record high in May this year and is 19% above its March 2000 level. The equivalent large-cap index is still well short of its record high.

As a result, the advance of the American stockmarket from its late 2002 low has been extremely broad. According to Richard Bernstein of Merrill Lynch, most S&P 500 constituents outperformed the index in each of the years from 2000 to 2005. At last this year the trend has begun to change; a slight majority of shares have underperformed the index.

A shift in favour of larger shares would be the most likely result of an American economic slowdown. That should prompt investors to opt for the safety of multinational groups, with a spread of products and operations that confers some protection from the economic fall-out.

And the long period of large-cap underperformance has caused valuations across the market to become compressed. Back in August 2000, according to Ronan Carr of Morgan Stanley, the most highly valued 20% of the American stockmarket traded on a prospective price/earnings ratio of 57.4, compared with just 7.7 for the bottom 20%. By July of this year, the respective multiples were just 27.4 and 9.7. No longer do investors have to pay such a big premium for quality.

The bad news for America's financial-services industry is that active fund managers struggle to outperform the index when large-cap shares are doing well. It is in smaller stocks, which are more poorly researched, where the best opportunities for bargain hunting can usually be found. So fund managers can look forward to a lot of complaints from clients when they lag behind the S&P. Perhaps that celebratory drink should be a low-alcohol beer.

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China's stockmarkets

Imperfect markets

Oct 5th 2006 | HONG KONG
From The Economist print edition

China's different share classes damage its own prospects

THOSE who believe that markets are efficient should avoid looking too closely at China. International investors who buy shares in Chinese companies through the Hong Kong Stock Exchange price Angang New Steel, the country's second-largest producer, at about six times earnings. It is not a lofty valuation, yet it is still too rich for investors living in mainland China. They pay 17% less for shares in Angang that carry identical legal rights but are traded just across the Chinese border in Shenzhen. The situation is reversed in the case of Luoyang Glass, a company with no earnings and little growth. Its shares cost three times more on the Shanghai Stock Exchange than they do in Hong Kong.

Such disparities are hardly exceptional. Thirty-three companies with a collective market value of $257 billion have shares trading simultaneously on the mainland and in Hong Kong. As with Angang and Luoyang, their shares carry identical legal claims on assets and profits. Theoretically, they should be similarly valued if markets work as they should, allowing buyers and sellers to converge on a price.

In China they do not. In every case the value of shares in the mainland and Hong Kong is different. This affects investors, but the biggest cost is to China itself. The jumble of valuations means the capital markets are not providing one of their greatest public benefits, price discovery, which serves as the invisible hand directing capital to where it can be best used.

Legally, the shares have only one critical distinction: those permitted to purchase them. Chinese residents must invest through the mainland markets in so-called A-shares; non-Chinese investors are mostly restricted to buying Hong Kong's H-shares, in Hong Kong dollars.

Broadly, bigger and more recognisable companies, such as Bank of China, tend to trade at a premium in Hong Kong. Smaller companies trade at a premium on the mainland. The discount of H-shares to A-shares has narrowed over the past six years from about 90% to below 30%, as prices in the Hong Kong market have risen and prices on the mainland have (until recently) stagnated (see chart). That, at least, seems promising. An earlier attempt to attract foreign capital through special B-shares sold on the mainland is an ongoing disaster. Scores of companies issued these shares, but the market never took off. When they trade at all, it is at a steep discount to A-shares, which, once again, carry identical legal rights.

The roots of this mess go back to the Chinese government's ambivalence over the nature of stockmarkets. It may have liked the idea of foreign capital and the enhanced economic growth and efficiency markets can deliver, but it was less partial to relinquishing control. So the authorities permitted limited sale of shares but kept a grip on ownership. Without ownership, however, it is questionable whether shares have any true value. If the shares are to be useful, at the very least there must be pricing coherence. Recently, there have been some encouraging moves. China has, for example, granted several foreign firms and investment groups rights to own limited amounts of A-shares. Some have quietly created ancillary products such as derivative-like “promissory notes” that, in essence, enable them to resell their A-shares to other market participants, and to arbitrage by matching A-shares selling at a discount to H-shares selling at a premium (but not the other way around).

More mysteriously, B-shares leapt in price during September amid rumours that the government might allow the share classes to merge. Other opportunities for cross-border trades are appearing. On September 28th Morgan Stanley, an investment bank, listed a $244m closed-end fund in New York with the unusual right to invest in A-shares, as well as other Chinese securities. The retail offering was snapped up within 45 minutes. Credit Suisse, a bank, reckons that almost $100 billion in A-shares will be issued in the next four years. The sounder the market these flow into, the better it will be for China.

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Outsourcing mortgages

Home and away

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From The Economist print edition

India moves in on the West's mortgages

SOMEBODY'S misfortune is often another's big chance. Rising interest rates and shaky property prices have made life harder for homeowners and mortgage lenders in America and elsewhere. Many mortgage providers are responding by outsourcing processing work to specialist firms. According to NelsonHall, a consultancy, the total annual value of such outsourcing contracts around the world is about $10.9 billion, with about a third of that in America alone. As yet, only a small proportion is being sent offshore. But as costs mount, says Sunil Mehta of NASSCOM, the Indian outsourcing industry's lobby, mortgages are “ripe for offshoring”.

It has also, he says, reached an “inflection point”. India in particular is poised to benefit from a huge rise in “mortgage-process outsourcing” in the next few years—worth anything from $100m-150m a year to $3 billion-7 billion. Big lenders are now using their own “captive” operations in India for many mortgage processes, and independent “third-party” business-process outsourcing firms are also on the hunt for work.

One force driving this, as usual, is cost. Higher interest rates eat away at the money-spinning business of refinancing outstanding mortgages, slash business volumes and squeeze margins. So the attractions of a low-cost destination, such as India, increase. Mortgages, moreover, involve a whole range of processes ripe for outsourcing. At “origination”, they might include telemarketing, data entry and document verification. “Servicing” a mortgage can be performed remotely. So, to some extent, can managing defaults and “securitising” mortgages by aggregating them and dicing them into tradable instruments. Victor Martinez-Angles, of Genpact, India's biggest independent outsourcing firm and once an arm of General Electric, estimates that 50-80% of mortgage-related work can be done offshore.

In August Genpact became the latest Indian firm to acquire an American “front office” when it completed the purchase of MoneyLine Lending Services, an American mortgage-service firm. The savings in using Indian firms can be huge. Mr Martinez-Angles reckons Genpact can make savings of 30-40% for each mortgage loan compared with an American bank. But Andy Efstathiou, of NelsonHall, says that the main impulse behind outsourcing in the industry as a whole is not so much cost-cutting as shifting from a fixed cost base to a variable one: the contracts give companies more flexibility to scale up and down as volumes vary.

Like all outsourcing to India, however, mortgage-servicing is vulnerable to protectionism, justified by fears about data security, such as those aired in a British television “sting” operation this week in which Indian call-centre workers were caught extracting confidential information from customers and selling it. NASSCOM remains confident that India's record on this is as good as anywhere's, though Mr Mehta says one attraction of the mortgage business for India is the potential for its firms to diversify away from “voice-based” work—ie, call centres. Expanding operations in the West, through acquisition or otherwise, recognises the limits of “offshoring”. Some mortgage services—such as advising nervous customers on the biggest financial deal of their lives—might actually be better performed at home, or even face-to-face, than down a telephone line from India.

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European trade

Take your partners

Oct 5th 2006
From The Economist print edition

The European Commission hatches new trade plans

“EUROPE needs to import to export.” That is the slogan of the European Commission's new strategy for securing its economic place in the world, unveiled this week by Peter Mandelson, the European Union's commissioner for trade. The soundbite, of course, gets the economics precisely backwards: exports are the price a country must pay for its imports; Europeans toil away making stuff for others to consume only so they can in turn get their hands on the fruits of foreign labours.

But the slogan does capture two awkward truths European exporters must now confront. First, only by offering to open its own markets can the EU hope to persuade foreign countries to open theirs. But with the collapse of the Doha round of trade talks, it is not obvious to whom the Europeans should make their offers. Second, European companies are now part of elaborate global supply chains. Clumsy efforts to protect some of them from foreign competition deprive others of the cheap inputs they need to thrive in world markets.

The new trade strategy looks at both of these dilemmas, among others. Though Mr Mandelson insists that he remains wedded to multilateral negotiations at the World Trade Organisation, he also fancies pursuing a bit on the side with other willing trade partners. The EU will pick its partners according to three criteria: do they offer a big, growing market? Are they cutting deals with America or Japan? And are they guilty of deterring European companies, either repelling them at the border with high tariffs, or bogging them down in cumbersome rules and regulations? The strategy names ASEAN, South Korea, India and Russia as priorities, as well as two regional blocks, Mercosur and the Gulf Co-operation Council, that it is already courting. The EU will reveal its plans for China at the end of the month.

The strategy also proposes to look again at how the EU protects its own borders, because its favoured weapons are prone to backfire. For example, EU ministers decided this week to slap anti-dumping duties on leather shoes from Vietnam and China, which threaten shoemakers in Italy, Portugal and Spain. But the duties are opposed by Europe's own retailers and some of its sportswear makers. Letting Asian workers stitch and glue sports shoes makes it possible for such firms to employ Europeans to design and market them.

Mr Mandelson presented his strategy as a way to help the EU become more competitive. Opening up to foreign rivals is, of course, an excellent way to foster competition in cloistered domestic industries. A pity then that most of his concrete proposals were about conquering markets abroad, and that the EU is still so ready to raise its defences at home.

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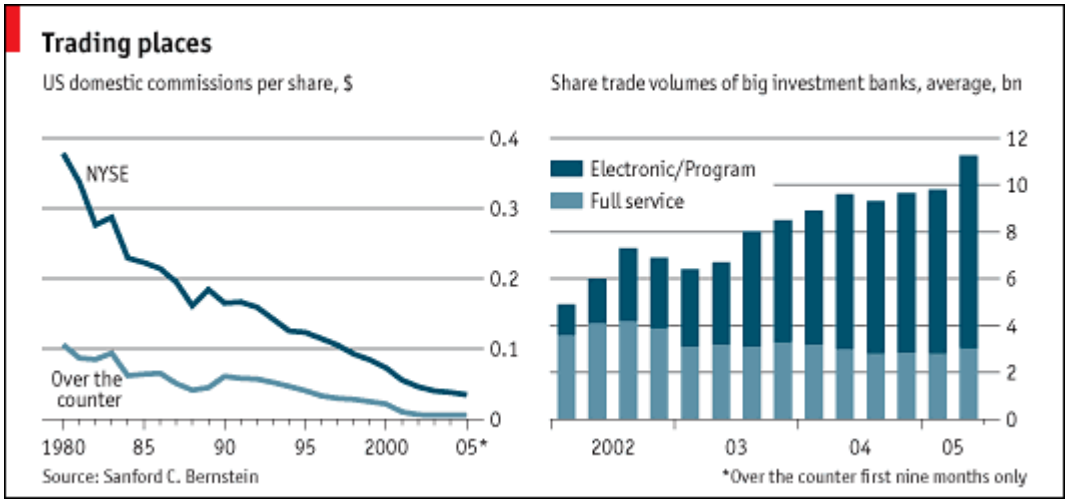
Share trading

The big squeeze

Oct 5th 2006 | LONDON AND NEW YORK
From The Economist print edition

Banks, brokers and exchanges fight over the crumbs of share trading



FOR 20 years, share traders have, like Mark Twain, been able to scoff at reports of their own demise. In the wine bars of Wall Street and London's Square Mile, their voices (and shirts) are as loud as ever. But though stockmarkets are buoyant, the banks, brokers and exchanges where they work are grappling with forces that they can barely control. Aggressive customers, competition from computers and encroaching regulation are transforming the once-iconic business of trading.

Barely a week goes by without new signs of upheaval. Banks and brokers, whose commissions on equity trades have fallen by 6% a year over the past 20 years (see left-hand chart, above), are trying to steal some of the exchanges' more lucrative business. In late September a group of the biggest American banks said they planned to set up a new electronic trading venue that would let them make large trades more cheaply and stealthily than they could on the New York Stock Exchange (NYSE) or NASDAQ. This follows earlier investments that banks have made in regional exchanges, such as Philadelphia and Boston, to challenge the two exchanges in New York.

In Europe, meanwhile, a big electronic broker called Instinet has unveiled plans to launch a new trading, clearing and settlement platform in conjunction with Fortis, a financial firm. Instinet claims the platform will be less costly and many times faster than any offered by the exchanges. Also in Europe, big investment banks plan to publish their own prices of trades done off-exchange; to date, this is done exclusively—and lucratively—by the exchanges themselves. Competition in this area will be thrown open late next year when a new European Union rule called MiFID seeks to break up trading monopolies.

“What you're seeing is fragmentation of liquidity and new types of trading venues,” says Glenn Bedwin of Thomson Financial, an information service. “Everyone wants to decrease their transaction costs.” Although volume is booming, the commission of banks and brokers for each trade is being compressed in several ways. According to Sanford C. Bernstein, a research firm, in 2005 electronic and program trades accounted for 73% of the volume of the share trading of big Wall Street banks, up from 28% in 2002. The rise of electronic and “black-box” algorithmic trading has automated many jobs once done by traders; hyperactive clients such as hedge funds are also squeezing margins and demanding greater speed.

All this is likely to put pressure on bank profits, which have been boosted recently by mergers and

acquisitions, proprietary trading and lending to buy-out firms. On September 28th the Securities Industry Association, an industry lobby group, predicted that the American earnings of Wall Street banks would drop by 23% next year, in part due to competition from electronic exchanges. Banks and analysts say that may oversimplify the picture, but the trend is clear (see right-hand chart, above).

As banks seek to compensate for this by invading the exchanges' turf, the exchanges are responding in three ways: joining forces, fighting for business and cutting fees. The big American and European exchanges have tried—with mixed results—to cling to each other, both within their regions and across the Atlantic. Smaller exchanges are being collaborative, too. This week, for instance, OMX (which operates a group of Nordic and Baltic exchanges) unified the listings of companies in Stockholm, Helsinki and Copenhagen. “Everyone is starting to see the opportunities that a larger market creates,” says Magnus Böcker, head of OMX. Meanwhile Austria's stock exchange is part of a push for harmonisation of stock exchanges in central Europe.

But it is not all friendly. In America the NASDAQ has been poaching business from the NYSE. Faced with looming regulation and the fear that it might lose more business to computerised outfits such as NASDAQ, the NYSE bought the all-electronic Archipelago exchange. Mr Bedwin predicts that in Europe the biggest exchanges will all in coming years list the region's 500 largest stocks—what he calls the MiFID 500. And, partly to fend off the new competition, a number of exchanges and post-trading clearing services, such as the NYSE and LCH.Clearnet, which is based in London, have recently cut their fees.

The forces driving these changes increasingly include owners seeking to wring efficiencies and new revenues from these organisations (despite the bumper profits investment banks and exchanges have enjoyed this year). The industry is growing more incestuous, too, as investors seek to take stakes in all potential outcomes. For example, the biggest shareholder in Instinet is a private-equity firm called Silver Lake Partners. But that firm is also a big shareholder in NASDAQ which, in turn, has a substantial holding in the London Stock Exchange. From this week NASDAQ has the right to increase that stake if it chooses to do so.

It is likely that banks, as well as owners of exchanges and brokers, will continue to press them. Ultimately, everyone is fighting for every penny from share trading that they can get.

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Economics focus

Taped

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How some rich countries' over-regulation has hurt their productivity

FOR a decade or so, students of productivity growth have had even more to explain than usual. Simple theory suggests that countries with relatively low output per worker or per hour will catch up with the leaders, as capital and know-how flow to places where productivity is poor and the potential returns are greatest. Until the mid-1990s real life in rich countries fitted this template fairly well, as European productivity moved closer to America's. But now, even though money and ideas can hop across oceans in a mouseclick, convergence has not been as fast as it should have been: America has enjoyed a productivity surge, aided by investment in information technology (IT); Europe has not. Even though America may be losing a bit of steam and Europe gaining, economists have some explaining to do.

Plenty of reasons are on offer, such as the relative rigidity of most European labour markets, better American management, and America's superior universities and their close links with industries that make and use IT. Another likely culprit, though, is the regulation of product markets: if regulation makes competition less intense, it blunts companies' incentives to raise productivity and thwart their rivals. Granted, governments have been liberalising markets, from banking to gas supply, for years. But some countries have been opening faster and further than others. Measured by an index created at the OECD, the gap between the most and least liberal services markets widened in the 1980s and into the 1990s. Only in the late 1990s did it narrow, but some countries were still far behind.

A new paper* by Paul Conway, Donato de Rosa, Giuseppe Nicoletti and Faye Steiner, of the OECD, helps to fill in part of the productivity puzzle. It assesses the effect of regulation of services markets on the productivity growth of OECD countries. Manufacturing tends to be less regulated and more open to foreign competition, so a look at services probably captures most of the economy-wide effects. And services such as telecommunications and energy are important inputs for manufacturers.

Using the in-house index as a gauge of regulation, Mr Conway and his colleagues find that output per worker grows more slowly in more rule-bound markets. (Were they able to use output per hour, for which not enough industry-level data are available, the gains from deregulation might look a bit smaller.) However, this effect is concentrated in industries that either produce IT or use it a lot. This implies that weak competition does most harm by dulling the incentive to invest in IT.

They also ask whether regulation slows the rate at which laggard countries close the gap between themselves and the leaders. The lower a country's productivity, the more it has to gain by catching up—and the more damage red tape can do. Suppose, they say, that between 1995 and 2003, for each service studied, the freest standards in any country had applied everywhere. Then output per worker would have grown 0.2 percentage points a year faster in British businesses and 0.5 points faster in America, Finland and Sweden. The most regulated countries forwent more: a point plus in Canada, Norway, Portugal and Spain, and 1.8 points in Greece.

The authors go on to look at two channels through which regulation may have dampened productivity growth. One is by discouraging foreign direct investment (FDI). Economists broadly accept that FDI helps productivity grow. Partly this is because competition from foreigners spurs on the locals—especially important in services, where cross-border trade is less common than for goods. However, local firms may also enjoy “spillovers” from foreign entrants by imitating their methods or recruiting employees trained by the foreigners and steeped in their know-how. Mr Conway and his colleagues find that the degree of product-market regulation has a direct effect, accounting for 10% of the variation in FDI's employment share; direct restrictions on FDI explain a further 13%.

The other channel is investment in IT. Overall, for the period 1985-2003, the authors estimate that 12% of the country-by-country differences in IT investment, as a share of business's total, can be ascribed to variations in product-market regulation. America's relatively pro-competitive rules added more than four percentage points, relative to the OECD average, to its IT investment share; regulation pulled the figures for France, Greece, Italy and Portugal down by 2.5 to 3.5 points. By 2003, the differences were less than the average for the period, thanks to a closing of the regulatory gap, but they persisted nonetheless.

Everything that rises must converge

Why does IT matter so much? The greatest impact of advances in IT, notes Mr Nicoletti, has come since the mid-1990s. Countries with policies preventing their diffusion lost out. And because IT can boost productivity in many industries, its effects (or the absence of them) were felt across the economy. “Policies that prevent the spreading out of this technology”, he says, “are damaging precisely because of its general application.”

Even if the laggards are stirring, they still have much to do. In the European Union this includes the completion of the much-heralded single market in services. In manufacturing, says another new paper†, by Rachel Griffith, Rupert Harrison and Helen Simpson, of London's Institute for Fiscal Studies, the single market has increased competition, innovation and productivity as a consequence. Thanks to IT, America's banks and retailers have taken fuller advantage of huge continental markets for mortgages and groceries. Europe's would surely do the same.

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* “Regulation, Competition and Productivity Convergence”. OECD Economics Dept Working Paper No. 509, September 2006

† “Product Market Reform and Innovation in the EU”. CEPR Discussion Paper No. 5849, September 2006

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Evolution

Unity and diversity

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New insights into the origin of species suggest that biologists disagree less than they thought they did

MANY physicists are engaged in the search for a “theory of everything”. Biologists, smugly, think they have found one already. Organisms that survive long enough to reproduce and are attractive enough to find a mate pass their genes on to the next generation. Those that do not are evolutionary cul-de-sacs. But the details—how you go on from the basic principles of evolution to explain large-scale patterns in biology—are more divisive. Scientific camps form. Their leaders step onto soap boxes. And only rarely do people concede that their own theories and those of their opponents are not always mutually exclusive.

Nature Picture Library

Since the early 1970s, the two grandest patterns of life—how species are arranged in space and how they are arranged in time—have divided their opposing camps quite neatly. Those who squabble over space disagree about why there are more species in the tropics than anywhere else. To them, the tropics are either where species are more often born (cradles of diversity) or where they tend not to die (museums of diversity). By contrast, biologists concerned with patterns in time tenaciously debate whether new species come into being in a smooth and gradual manner, or whether the history of life is actually a series of bursts of change that are interspersed with periods when nothing much happens.

Two papers just published in *Science* have cast light on these questions, and their findings, if not necessarily resulting in compromise, do show the value of taking leaves out of other people's books. The “space biologists” have looked into time, namely the fossil record over the past 11m years. Meanwhile the “time biologists” have looked at the here and now and found evidence in living species for periods of rapid evolution in their genes.

Biological spacetime

The space biologists have the advantage that they agree about the pattern they are trying to explain. Almost all groups of life that have been studied—be they fungi, plants, vertebrates or invertebrates, and no matter whether they occur in forests, streams or seas—seem to have more species the closer they are to the equator.

To decide whether the tropics are a cradle or a museum, though, involves picking this pattern apart with

statistics. And statistics work best when you have more than one sample. That is the reason for reaching into the past.

David Jablonski, of the University of Chicago, and his colleagues created their samples by dividing the past 11m years into three periods. For simplicity's sake, they also chopped the Earth's surface into two: tropical regions and everywhere else, which they called the “extratropics”.

To avoid sampling bias, they restricted their analysis to one group of animals—the bivalve molluscs—that fossilise well. This allowed them to follow 431 “lineages” of marine bivalve through the course of geological time. The vast majority of these lineages appear in the tropics and then spread into the extratropics. In other words, the tropics do, indeed, act as cradles of biodiversity.

In fact, the pattern Dr Jablonski reports is probably more marked than his data suggest. That is because palaeontologists themselves are generally a temperate species and are most commonly found in the northern hemisphere. That means rocks in this region have been oversampled compared with those in the tropics. Also, tropical rocks tend to experience deep weathering, rarely poking above the ground as outcrops. That makes sampling them harder, even if you bother to look in the first place.

The tropics do, indeed, act as cradles of biodiversity

Both of these facts mean it is likely that some lineages which seem to make their first appearance in the extratropical fossil record actually started out near the equator. The cradle hypothesis, then, looks strong. But that does not necessarily mean the museum hypothesis is wrong—for, at the same time as the tropics were generating diversity they seem to have been preserving it as well. Although the bivalve lineages Dr Jablonski studied spread out from the equator in waves, they did not become extinct in the wake of these waves. Instead of being forced out of tropical regions as they travelled poleward, they accumulated there.

Common ground appears to be forming in time biology as well. The dispute is between the gradualists and those who think that the sudden shifts in fossil types seen in the geological record are real, rather than a consequence of the irregular way that rocks are laid down. It got rather personal a few years ago, with references to evolution by creeps and evolution by jerks. But, in a similar way to Dr Jablonski's study, which suggests that models of cradles and museums present a false dichotomy, a paper from a member of the gradualist camp of time biology endorses some features of jerky evolution.

Some jerks, some creeps

Mark Pagel and his colleagues at the University of Reading, in England, reasoned that the theory of punctuated equilibria (the formal name given to evolution in bursts) predicts a relation between the rate at which new species are formed and the rate of genetic change in an organism's recent past. A lineage that has spun off a lot of species will show more genetic change than one that has not. The alternative view, that evolutionary changes tick along gradually, suggests mutations would accumulate incrementally as time goes by, independently of how many new species a lineage spins off.

Dr Pagel studied 122 family trees this way. He found that in about a third of them, there was more change in the DNA in those trees where more species had been generated. He also found that punctuated evolution explained about 22% of such genetic changes, with the remainder unfolding smoothly through time. This means, among other things, that when biologists have calculated how long ago two lineages diverged by assuming change is regular, they may have their dates wrong.

Both Dr Jablonski and Dr Pagel, then, have found a degree of resolution between opposing ideas by persistently hacking away at the data. Both have also posed more questions to their respective fields. Why does punctuation contribute more to some lineages than to others? (Plants and fungi are more affected than animals.) How do lineages spread into the colder climates of higher latitudes?

Some of the old questions, though, are still rattling around like skeletons in a cupboard. Dr Jablonski's study does not, for instance, help to answer whether the tropics are a wellspring of species because a hotter climate brings a higher mutation rate, or because more intense interactions between species select for more rapid evolutionary change. In the spirit of compromise, there seems no reason why it could not be a bit of both.

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Herbal medicine

African genesis

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A pharmacopoeia for Africa

IT IS easy to forget that the pharmaceutical industry has its roots in the ancient art of botanising. That was the name apothecaries gave to the activity of collecting plants that time and tradition had shown possessed useful medical properties. Even the first synthetic blockbuster drugs, Bayer's aspirin and heroin, were minor modifications of molecules extracted from, respectively, willow bark and poppy seed-pods.

Much of the world still relies on herbs for its medicines. Used correctly, they can be extremely effective. The twin problems of herbal medicine, though, are ignorance about what truly works and what does not, and quality control of a product that is not the result of standard production methods. To help overcome those deficiencies in a continent that is particularly dependent on herbal medicine, a group of researchers is assembling a pan-African pharmacopoeia—a database of plants with medicinal properties.

The Association for African Medicinal Plants Standards, a collaboration of medicinal-plant scientists from 14 countries, plans to launch the first edition of this database by December. It will contain detailed profiles of 23 plants, including devil's claw, which is used to treat rheumatism; red stinkwood, whose bark provides an ingredient for prostate-cancer drugs; and African ginger, which is good for relieving headaches. The association's members plan to add another 30 plants early next year.

Each profile will contain descriptions of the plant itself, of its medical properties, and of chemical tests that can be used to identify it. Not only will this information help local healthworkers, by winnowing what works from what does not, it may also increase international trade in African herbal medicines.

According to the World Health Organisation, the global market for medicinal plants exceeds $60 billion a year. Most of this, though, is in plants from Asia. Increasing Africa's slice would be a useful boost to the continent's international trade. At the moment, African medicinal plants are often ignored because foreign buyers have no guarantee of the quality of the materials they are purchasing. The hope is that by telling buyers which herbs are valuable for what, which characteristics to seek when making a purchase, and which chemical tests identify active ingredients, the new pharmacopoeia will provide that boost. The pharmacopoeia, in other words, would create a set of standards that all parties could work towards.

Pharmacopoeias have been used to control the quality of medicines for centuries. England's first one appeared in 1618. Today, though, most of them focus on factory-made drugs. It seems unlikely that the association's efforts will launch another Bayer. But if they make African medicine more effective and boost trade to boot, that will be no mean achievement.

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The Nobel science prizes

The little and large show

Oct 5th 2006
From The Economist print edition

This year's Nobel science prizes have been awarded for cosmology and two sorts of genetics

WELL, the waiting is over for another year. The great and good of Sweden's Royal Academy of Science and of the country's principal medical school, the Karolinska Institute, have deliberated. The laurels have been assigned, if not yet awarded (that happens in December). And the disappointed will no longer have to cling to their telephones like politicians hoping for a ministerial posting. With much fanfare, the Nobel science prizes have been announced.

This year, the prize committees have done well. They have managed to pick winners who, if not exactly household names, have at least done work that has had some resonance in the wider world. The physics prize is for a piece of research that has enabled cosmologists to map the universe as it was before the first star formed. The physiology prize (or “prize for physiology or medicine”, as it is known in the citation) is for the discovery of a phenomenon called RNA interference, which helps cells fight off viral infections and is widely touted as a possible basis for a new class of drugs. The chemistry prize is for a piece of X-ray crystallography, a favourite subject of the academy's prize committees over the decades, and a way of awarding an extra physiology prize (since X-ray crystallography is used mainly to examine large biological molecules) without confessing that much of the intellectual oomph has gone out of chemistry in the century since Alfred Nobel, himself a chemist, drew up his will.

And the winners are

The physics prize went to John Mather of America's National Aeronautics and Space Administration (NASA) and George Smoot of the University of California, Berkeley. Together, they were responsible for discovering irregularities in the microwave radiation formed soon after the beginning of the universe, and which bathes the universe to this day.

The cosmic microwave background, as this radiation is known, began its journey about 300,000 years after the Big Bang in which everything started. When discovered, it appeared to be perfectly uniform. Some researchers, however, reasoned that it ought to carry imprints of the slight concentrations of matter that must have existed in the early universe if structures such as galaxies—and eventually stars and planets—were going to form. These concentrations would have acted as gravitational nuclei, drawing in gas from their surroundings and thus forming galaxies.

To test this idea, NASA built and launched a satellite called the Cosmic Background Explorer. Dr Mather ran the instrument on this satellite that looked for telltale variations in the microwave background, and Dr Smoot analysed the results, which were published in 1992. Their work, and subsequent refinements of it using a second satellite called the Wilkinson Microwave Anisotropy Probe, not only showed the ultimate roots of galaxies, it also provided evidence that the early universe underwent a sudden, massive expansion known as inflation.

Andrew Fire, of Stanford University, and Craig Mello, of the University of Massachusetts, were not the first people to notice the phenomenon now known as RNA interference, but they were the first to have an inkling about what was happening. The observation they built on, first made in plants, and then extended to animals, was that the activity of individual genes can be silenced by versions of a molecule called RNA. This substance is similar to DNA (the chemical difference is in the group of atoms employed to stand as one of the four chemical “letters” of the genetic alphabet). The main physical difference is that RNA's molecules usually come in single strands, unlike those of DNA, the material of the genes, which are usually double-stranded (the famous double helix).

One of RNA's jobs in the cell is to act as a messenger: RNA copies of DNA genes are translated into protein molecules in cellular structures called ribosomes. In a nutshell, what Dr Fire and Dr Mello found, in 1998, was that what silences genes is adding double-stranded versions of their RNA messengers to the mix. This stimulates the formation of what are known as RISC complexes, which carry part of the double-stranded RNA around as a reference, and destroy any RNA that matches it.

Recognising and destroying double-stranded RNA is thus a safe way of attacking infection

The reason, from the cell's point of view, for doing this, is that healthy animal and plant cells never make double-stranded RNA. On the other hand, many viruses do. Recognising and destroying double-stranded RNA is thus a safe way of attacking infection. Whether that insight can be turned into drugs remains to be seen. But many are trying, and billions of dollars rest on their success.

Roger Kornberg, the winner of the chemistry prize, and another member of the faculty of Stanford University, studied the process by which genes are copied into RNA in the first place. This is done by an enzyme called RNA polymerase, which binds to the DNA and runs along one of the strands of the double helix. Each time it comes to a new chemical letter on the strand it is reading, it reconfigures itself to add a complementary letter to the RNA molecule it is creating.

Dr Kornberg worked out the details by crystallising the complex of DNA, RNA and polymerase at various stages of the process. He then photographed each version of the complex with X-rays.

That process of X-ray crystallography, which calls for a lot of complex mathematics rather than the mere creation of a photographic image, was invented by two Britons, Sir William Bragg and his son Lawrence. They jointly won the Nobel prize for physics in 1915. Coincidentally, Dr Kornberg's father, Arthur, is also a Nobel laureate. He won the physiology prize in 1959 for working out the details of how DNA is synthesised. Whether such familial talent is a matter of nature or nurture will, no doubt, be the subject of a future prize.

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General Pervez Musharraf

Military misjudgment

Oct 5th 2006
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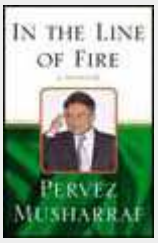
The Pakistani leader's memoir may be a bestseller, but it does him little justice

AFP

In the Line of Fire: A Memoir
By Pervez Musharraf



Free Press; 354 pages; $28.
Simon and Schuster; £18.99

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Amazon.co.uk

THERE are good things to be said about General Pervez Musharraf, Pakistan's president and army chief, and he is, as he might put it, proud and unstinting in his resolution to say them, over and over, in his cliché-ridden and boringly boastful autobiography, “In the Line of Fire”.

General Musharraf—and there are enough phrases familiar to those who have followed his career to prove that he wrote quite a lot of it—comes across as humourless, vain and insecure. Sentences as smug as, “My career was now well on course, given all my qualifications and achievements”, are spattered across almost every page. There are many references to the president's (allegedly) fine musculature. Any less than glorious event in his life, after at least a refreshingly sinful youth, is blamed on some less worthy individual, a dull superior or jealous peer, whom the author is all too happy to name. And yet, painful though it is to read, this is a quite remarkable book, about dramatic events and, as the occasional sentence lets slip, an interesting and impressive man.

For a start, the book's timing is remarkable. It is unusual for serving heads-of-state to publish memoirs, for good reason. General Musharraf denigrates Pakistan's chief ally, America, for the bullying way in which it manages its foreign policy and for failing to live up to its promises. He is also bafflingly rude about India, given that he has staked his name on making peace with it. Of India's leader, he says: “The initial signs of sincerity and flexibility that I sensed in Manmohan Singh seem to be withering away.” He suggests that Osama bin Laden is not, as often supposed, in Pakistan's wild northern areas, but in eastern Afghanistan. Hamid Karzai, Afghanistan's leader, whom General Musharraf accused of resembling an ostrich last week at a bad-tempered summit in Washington, DC, is not pleased by the book. Neither is almost anyone in Pakistan, although it is selling briskly there (see article). General Musharraf scorns most of the country's civilian politicians—tactless, if justifiable—including some of his supporters.

Insults aside, the book does not tell us much that is new. Most interesting are the details of events leading to the arrest in Pakistan of several top terrorists, including Khaled Sheikh Mohammed, the architect of the attacks on the twin towers, and other al-Qaeda members; General Musharraf says 689 al-Qaeda members have been arrested, of whom 369 have been handed over to America. That is a testament to the efficiency of Pakistan's security services, even though Mr Musharraf accuses America of having failed to provide the technical kit it promised.

Such digs at the superpower may be for the benefit of Pakistanis, many of whom find General Musharraf too quick to leap to its bidding. But the book is meant for a Western audience, by whom, it is clear, General Musharraf considers himself ill judged. It contains bold treatises on the political and economic reforms he has overseen since stealing power in his 1999 coup. These include a messy, but promising, effort to devolve power to the local level, and the creation of elected councils with fixed quotas for women representatives. There are also quotas for women in provincial and national assemblies. General Musharraf has given a boost to female emancipation in Pakistan, although the full impact of the changes he has introduced will not be felt soon. Even better, he has delivered broad structural improvements to Pakistan's economy, which had been in a desperate way. This was not, as he suggests, the result of his own genius. He is economically semi-literate. But he can take credit for appointing wise technocrats.

In short, heaven forbid that anyone unfamiliar with Pakistan should wholly trust this book. General Musharraf is as partial as any campaigning politician. One monstrous example is his account of a short war with India at Kargil in 1999, when he was merely army chief. It began when Pakistani state-sponsored jihadist militants attacked across the front-line in contested Kashmir, drawing a ferocious Indian response. General Musharraf calls this an over-reaction—but if it were, it was understandable—and he says that India's army came off worse in the fray, even to the point where the military ran out of coffins for their dead. Yet he omits to mention the hundreds—some say thousands—of Pakistani fighters who were slaughtered in a humiliating retreat.

Disingenuously, he says the war at Kargil was an important catalyst in the peace process that followed: if that is true, it is because Pakistan, not India, was forced to the table by the drubbing it took there.

An election is due in Pakistan next year, and General Musharraf is increasingly unpopular. This is because of a litany of perceived failures, including a muddle-headed war he has prosecuted in the northern areas, and rising inflation. It is also because, despite their appalling experiences of civilian leadership, and their acquiescence in his coup, Pakistanis have tired of army rule.

The bad news in this book is that General Musharraf refuses to recognise this truth: “The Pakistan Army has always been held in high esteem as the only powerful stabilising factor in the nation,” he insists. He does not seem to show any inclination to quit his twin role, as he is constitutionally obliged to do.

In the Line of Fire: A Memoir.
By Pervez Musharraf.
Free Press; 354 pages; $28.
Simon and Schuster; £18.99

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About sponsorship

American foreign policy

Easily enough for two volumes

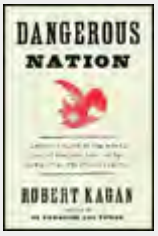
Oct 5th 2006
From The Economist print edition

ROBERT KAGAN rose to prominence in 2003 with “Of Paradise and Power”, a bestseller about America and Europe, which began: “It is time to stop pretending that Europeans and Americans share a common view of the world, or even that they occupy the same world.” Now he has returned to the stage with “Dangerous Nation”, the first of a projected two-volume history of American foreign policy.

This new book is as fat as “Paradise” was slim. It is also, at least on the surface, as recondite as “Paradise” was topical, ending abruptly with the Spanish-American war of 1898. But do not be put off by any of this. “Dangerous Nation” is a first-rate work of history, based on prodigious reading and enlivened by a powerful prose style. It also casts a bright light on America's role in the world—and on its manifold tensions with other countries.

Mr Kagan, a senior associate at the Carnegie Endowment for International Peace, argues that America has never been isolationist. Even as part of a “City on a Hill”, Americans were an expansionist people, who overran their competitors, starting with the Native Americans. As the country matured it became bolder and more self-confident.

Dangerous Nation: America's Place in the World From its Earliest Days to the Dawn of the Twentieth Century
By Robert Kagan



Knopf; 508 pages; $30

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America entered the 19th century “not with cloistered modesty but with grand dreams of national expansion”. Those dreams were put on hold as Americans fought a civil war over how the nation should develop. But they were soon resumed; America pushed out its own frontiers and took an expansionary view of its role in the world.

One motive driving this expansion was the insecurity of settlers in a hostile land. Many felt rather as Catherine the Great is supposed to have felt about Russia: “I have no way to defend my borders but to extend them.” Another was the lust for land. But these down-to-earth motives went hand-in-hand with loftier ones.

America not only invented the modern liberal republic, but also a new sort of foreign policy founded on a universal ideology about human nature and human affairs. The Declaration of Independence firmly established the American conviction that man's inalienable rights transcend territorial borders and blood ties. And this universalist idea grew ever stronger in subsequent years. In particular, American evangelicals reinforced America's belief in the holy trinity of republicanism, democracy and commerce.

Americans might prefer to regard their country as an inward-looking place that periodically got dragged into the world's affairs through no fault of its own. But contemporaries knew differently. In 1817, America's representative in London, John Quincy Adams, reported that “the universal feeling of Europe in witnessing the gigantic growth of our population and power is that we shall, if united, become a very dangerous member of the society of nations.” Two years later a congressman, returning from a visit to Europe, noted that everyone regarded Americans as “an ambitious and encroaching people”.

“Dangerous Nation” will be a bit too Whiggish for many professional historians: Mr Kagan, who has spent the past few years, poor fellow, living in Brussels, trying to explain American power to the Euro-establishment, cannot help but write history with one eye on the present. Thus slave-holding America is a “rogue state”; the civil war is America's first experiment in ideological conquest; and reconstruction is America's first experiment in “nation building”.

But Mr Kagan's Whiggery helps to bring long-dead diplomatic history to life: who else but a professional

historian would want to read about the Monroe doctrine except for the light that it throws on America's current dilemma? And who but a bore could resist a bit of Whiggery when you come across reflections on America like the following one from the *Edinburgh Review* of 1818: “Where is this prodigious increase of numbers, this vast expansion of dominion, to end? What bounds has Nature set to the progress of this mighty nation? Let our jealousy burn as it may; let our intolerance of America be seen as unreasonably violent as we please; still it is plain, that she is a power in spite of us, rapidly rising to supremacy.”

Dangerous Nation: America's Place in the World From its Earliest Days to the Dawn of the Twentieth Century.
By Robert Kagan.
Knopf; 508 pages; $30

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Amazon worldwide bestsellers

Lives, still and not so still

Oct 5th 2006
From The Economist print edition

Six new memoirs have jumped on to the bestseller list

THREE memoirs in Amazon's top ten have been there for over a year, steadily selling thousands each week. So publishers will be watching to see if the six newcomers on the list enjoy the same staying power.

Pop followers can be counted on to keep buying "U2" by U2 and Daniel Mendelsohn fans his Holocaust epic. Whether the second biggest seller—Pervez Musharraf's memoir—can match them remains to be seen. Still, it has had a good start.

A week (and several reprints) after publication, 53,000 copies had been distributed in America and 40,000 in Britain, India and Pakistan. There are contracts for translations into Urdu and Hindi and offers for a Mandarin and a Marathi edition. More will follow. General Musharraf's book may be bad politics but it looks like good business.

Me, moi, myself

1	**U2**	by U2 and Neil McCormick
2	**In the Line of Fire: A Memoir**	by Pervez Musharraf
3	**The Lost: A Search for Six of Six Million**	by Daniel Mendelsohn
4	**The Glass Castle: A Memoir**	by Jeannette Walls
5	**The Life and Times of the Thunderbolt Kid: A Memoir**	by Bill Bryson
6	**The Year of Magical Thinking**	by Joan Didion
7	**The Game: Penetrating the Secret Society of Pickup Artists**	by Neil Strauss
8	**Marley & Me: Life and Love with the World's Worst Dog**	by John Grogan
9	**The Confession**	by James E. McGreevey
10	**Running with Scissors: A Memoir**	by Augusten Burroughs

Source: Global sales from Amazon.com, Amazon.co.uk, Amazon.ca, Amazon.de, Amazon.fr & Amazon.jp, from September 1st-27th 2006

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Non-violence

Nice idea

Oct 5th 2006
From The Economist print edition

SANCTIMONIOUS drivel dressed up as political philosophy. That, put crudely, is how many people regard pacifism. Non-violence may be a good way of tweaking the conscience of a liberal society, but it is a hopeless way of confronting tyrants, aggressors and madmen.

Mark Kurlansky, in his erudite and eloquent book, tries to put the other side. War is horrible, mostly fought for visibly bad reasons. Even ostensibly just wars do more harm than good. In short, violence invariably leads to more violence. Why not try pacifism instead?

Peace-loving and saintly thinkers, leaders and martyrs of past ages are indeed inspiring. Leo Tolstoy, Confucius and Mahatma Gandhi make predictable appearances, as do some other figures, whose stories are rescued from undeserved obscurity. And many wars' imperfect or disastrous outcomes are overlooked in the histories written by the victors. The author pokes some interesting holes in both America's civil war and its struggle against the British.

But he stretches credulity when he tries to weave it all together. The great world religions have pacifist strands—but that is only part of the picture. Jesus said "I come not to bring peace but a sword." Muhammad fought 19 military campaigns.

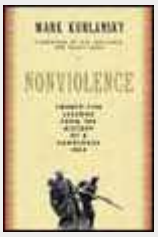
The most irritating aspect of the book, however, is not its content, or its logical lapses, but its tone. Mr Kurlansky implies that the opposite of a pacifist is a warmonger. If you do not believe (as he does) that the success of Danish non-violent resistance to Nazism shows that the second world war was the wrong way to defeat Hitler, then you are not just wrong, you are bloodthirsty, ignorant and stupid.

He blithely ignores the third position of the reluctant warrior, who takes up arms only when all else has failed, sombrely aware of the ghastly mess that will ensue. Yet it is in that part of the moral spectrum that the deepest thought can be found.

The Dalai Lama's foreword is rather better than the book. "Whenever conflicts and disagreements arise, our first reaction", he writes, should be "to ask ourselves how we can solve them through dialogue and discussion rather than through force." Amen to that: force should never be the unthinking first resort. But in a sinful world it may have to be the last one.

Nonviolence: Twenty-Five Lessons from the History of a Dangerous Idea.
By Mark Kurlansky.
Modern Library; 224 pages; $21.95.
Jonathan Cape; £12.99

Nonviolence: Twenty-Five Lessons from the History of a Dangerous Idea
By Mark Kurlansky



Modern Library; 224 pages; $21.95.
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New fiction

Voyage of hope and despair

Oct 5th 2006
From The Economist print edition

MICHAEL ARDITTI'S fifth novel is a fine example of how resonant fiction based on real events can be. Through the memoir of Karl Frankel-Hirsch, the 15-year-old heir to a department-store fortune, the author tells the true story of the *St Louis*, a German liner that left Hamburg in May 1939 carrying 900 Jewish refugees fleeing Nazi Germany after years of persecution and the terror of *Kristallnacht*.

A Sea Change
By Michael Arditti

Maia Press; 295 pages; £8.99

Buy it at
Amazon.co.uk

Bound for Cuba, where the refugees were to await their entry permits into the United States, the *St Louis* became a pawn in a political power game. Cuba reneged on its promise to allow the refugees entry; President Roosevelt ignored pleas for them to be let into America; and after nearly four weeks at sea the ship was forced to turn back to Europe. Some of its passengers (including an eight-year-old girl who came to live with this reviewer's grandparents) were offered asylum in Britain, but many were condemned to die in the Holocaust.

Mr Arditti has written sensitively about many weighty issues—betrayal, fanaticism, faith—in his previous books. Once again he treats his subjects with empathy, neither trivialising their horror nor glamorising their plight for fictional benefit. His skill lies in weaving the experiences of the fictional Karl and his family into accurately re-told historical events—a burial at sea, a flawed mutiny, an attempted suicide—all featuring true-life characters. There is the evil Otto Schiendick, the Nazi party's representative on board; Manuel Benitez, the venal Cuban director of immigration; and Max Loewe who, overcome with fear of returning to Germany, slit his wrists and threw himself overboard.

But it is the voice of Karl, whose raw adolescent energy leaps from the pages, that gives “A Sea Change” its compelling realism. Through Karl, the author portrays the barbarity of the Nazis, the terror of persecution, and the despair that floods the ship when it is turned away from Havana, the city's “ribbon of lights promising a warmth and a welcome that would never be ours.” Paralleling the story of the *St Louis* is Karl's own voyage of discovery in which he falls in love for the first time and, in the face of hardship, becomes a man.

“A Sea Change” is a powerful novel of courage in the face of betrayal. But Mr Arditti's book is also a tribute to the passengers who sailed on the *St Louis* in search of freedom, and an elegant memorial to those sent back to Europe to face death at the hands of the Nazis.

A Sea Change.
By Michael Arditti.
Maia Press; 295 pages; £8.99

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Journalism in Zimbabwe

Chronicle of a death foretold

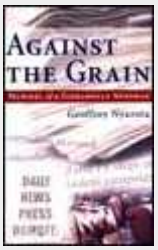
Oct 5th 2006
From The Economist print edition

ZIMBABWE has become a byword for economic and political meltdown. Yet in 1980, when the country first won black majority rule after years of guerrilla warfare, Robert Mugabe—a teacher who became first a guerrilla leader and ultimately president—was hailed as someone who would bring racial reconciliation, democracy and economic prosperity to his country. How did the dream turn into a nightmare and Mr Mugabe into a tyrant?

Geoffrey Nyarota watched the drama unfold. As a young teacher, he had experienced at first hand both the violence of the previous regime and the excesses of those supposedly liberating the country. When his teaching career was cut short by the liberation struggle, he became a journalist on government newspapers and, after independence, quickly rose through the ranks. He became the editor of the then independent *Financial Gazette* before launching the *Daily News* in 1999, standing up for a free press against an increasingly repressive government.

This earned Mr Nyarota multiple awards, but also much hardship. Having survived harassment, intimidation and the bombing of the *Daily News* printing press, he was forced out of his job. He went into exile in America in 2003. The *Daily News* closed shortly afterwards.

Against the Grain: Memoirs of a Zimbabwean Newsman
By Geoffrey Nyarota



Struik; 352 pages; $29.95

Buy it at
Amazon.com
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Mr Nyarota's memoir charts both his journalistic career and the events that have shaped Zimbabwe over the past 26 years. It describes Mr Mugabe as an intellectual disconnected from reality after a decade in prison and, following his release in 1974, a few years as a guerrilla leader based in Mozambique. But the president did not suddenly morph from angel to demon. Mr Nyarota documents early signs of his ruthlessness and hunger for power: suspected rivals within the liberation movement being crushed; the minority Ndebele tribe and its leader, Joshua Nkomo, brutally brought in line with, he estimates, 20,000 people killed in Matabeleland and the Midlands in the early 1980s, after Mr Mugabe and his ZANU-PF party won their first election. From early days too, no dissent was tolerated in the media.

According to Mr Nyarota, it was Samora Machel, Mozambique's charismatic first president, who, despite his Marxist leanings, convinced Mr Mugabe to make room for capitalism and multi-racialism. Those early compromises proved to be temporary, Mr Mugabe's ultimate ambition being first to consolidate and then to hang on to power at any cost.

There is ample material here for an excellent book. Unfortunately, a haphazard structure and too much irrelevant detail have resulted in a disappointment. All too often, readers have to fish for the good parts that are drowned in the mix. The Zimbawean editor could have used a good editor himself.

Against the Grain: Memoirs of a Zimbabwean Newsman.
By Geoffrey Nyarota.
Struik; 352 pages; $29.95

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About sponsorship

Bertolt Brecht

A man for all seasons

Oct 5th 2006
From The Economist print edition

Fifty years on, Bertolt Brecht's finest plays are being revived in Britain and America

AFP

Meryl as Mother Courage

IT is hard for Germans to escape Bertolt Brecht. If not quite the national playwright that William Shakespeare is for the English, in the great plays of his maturity—"The Good Person of Szechuan", "Mother Courage and Her Children", "The Life of Galileo" and "The Caucasian Chalk Circle"—Brecht easily matches the theatrical scope and psychological depth of Shakespearean tragedy. Yet his obsession with politics, his theories about epic theatre and alienation and the absence of any romance have left him little liked and rarely performed in Britain or America.

That tide may now be turning. In New York, Meryl Streep has just appeared as Mother Courage at the Delacorte Theatre in Central Park, in a translation by Tony Kushner, who wrote "Angels in America". Mr Kushner has loved Brecht's epic since he first read the play about a mercenary woman tramping her way around the battlefields of the Thirty Years War: "'Mother Courage' with Meryl Streep was a dream come true," he says, adding that the play is a "chastening experience".

Brecht, like Shakespeare and Chekhov, is a master at projecting "complex ideas [that] hang on an incredibly compelling narrative". The drama raises great questions—who profits from war, who holds the truth, who is authentic and who false—and each of these stems from a very simple beginning. People queued for five hours to see Ms Streep, with one critic claiming that her Mother Courage "may be the most unrelenting, animalistic thing she's ever done". But, Mr Kushner adds: "They went away with something else, this voice of Brecht's: secular, cynical, wise, but which also connected with their humanity."

In Britain, English Touring Theatre's production of "Mother Courage" opened on October 5th; and at the Royal National Theatre "The Life of Galileo", Brecht's study of the scientist whose discoveries shook Christianity, has been one of the hits of the late summer. Directed by Howard Davies in a translation by Sir David Hare, this Galileo is one for our time: engaging, accessible, full of quarrels about secularism and the rigidities of faith.

Simon Russell Beale as Galileo is a cigarette-smoking, whisky-swigging intellectual who would not be out of place in a red-brick science faculty. The revolving set, with its stylish cupola and planetary holograms, could be part of the CERN particle physics laboratory.

Mr Davies acknowledges that the playwright is still a challenge for British audiences: "'Galileo' is a risky proposition. Political theatre in Britain since the late 1970s has taken a dip, and Brecht was always perceived as political. But, in a big way, it's timely to revive him. 'Galileo' describes a schism over interpreting the world: how could anything be more relevant? Considering the Middle East and the issues that have arisen from that, I think the play has if anything increased its currency."

But don't Brecht's own ideas inevitably inhibit today's directors? "Once, those theories were vital for a strike against bourgeois theatre. That's their context. Now, they're scaffolding and don't have to be shown," argues Mr Davies. The production's 21st-century dress is complemented by Sir David's brisk script. A dense scholasticism and clunky, scene-setting rhymes have been replaced by an urbane English demotic that is plain and unadorned.

Sir David, too, believes that Brecht remains modern: “After the fall of the Berlin Wall in 1989, communism was seen to have failed. That seemed to render Brecht, a Marxist, irrelevant. Sufficient years have passed to let us see his works anew. The great plays show deeply flawed individuals engaged in the tactics of survival.”

What about those Brechtian strictures about “objectivity” and “distancing”, where an audience was supposed to be emotionally disengaged from the action on stage, the better to learn about human weakness and folly and how politics holds sway over daily life? “Staging the plays proves that Brecht cannot be held in aspic,” Sir David says. “The time is past when all we were doing in Britain were tedious imitations of the stiff, formal style he invented at the Berliner Ensemble [the group Brecht founded in 1949 with his wife, Helene Weigel]. Audiences can feel a historical wind and that's what Brecht deals with: the movements of history.”

Mr Kushner, who, like Sir David and Mr Davies, has never had doubts about Brecht's status, stresses the empathy of his major works: “His world-view is one of contradictions, dreadful dilemmas, not sensual but not ultimately cynical either. When you see ‘Mother Courage', you say, ‘We all feel we are her now’.”

“Mother Courage and Her Children” is on tour with English Touring Theatre until December 2nd

“The Life of Galileo” is at the Royal National Theatre, London, until October 31st. Tickets are available at nationaltheatre.org.uk

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Iva Toguri

Oct 5th 2006
From The Economist print edition

Corbis

Iva Toguri, a victim of mistaken identity, died on September 26th, aged 90

MANY years after the end of the war in the Pacific, a former tail-gunner who had been stationed in New Guinea wrote a letter to a veterans' magazine. He wished to share his memories of a voice. Every night in the spring of 1944, huddled in a tent with his comrades, he would hear a woman speaking behind the crackle and whistling of the Halicrafter radio. “Hi, boys!” she would say, or sometimes “Hi, enemies! This is your favourite playmate.” She would play swing and jazz, introduce “some swell new records from the States” and then, almost as an afterthought, mention that a Japanese attack was coming: “So listen while you are still alive.”

They listened happily, as did American troops all over the Pacific. It was rare and good to hear a female voice, even through several layers of interference and even with the sneer of death in it. Whether it was one woman, or many different women, did not matter. They could picture her: a full lipstick smile, ample curves, perfect skin, part Hedy Lamarr and part the sweetheart left at home. She was a temptress and a vixen, and her name was Tokyo Rose. For even myths must have names and addresses.

After the war American pressmen descended on ruined Tokyo to search for the girl they had invented. The Hearst empire was offering $2,000 for an interview and, after a while, a slight, pale, smiling young woman came forward. She had worked for Radio Tokyo and, for two years, had part-hosted a programme called “The Zero Hour”. Her name was Iva Toguri: an American citizen, born and raised in California, and now in desperate need of money to get home. She had never called herself Tokyo Rose, on air or otherwise, but there seemed no harm in taking the identity when the Hearst men asked her. Yes, she was “the one and only”, the “original”.

For a while it was glamorous to be this person. Troops mobbed her for her “Tokyo Rose” autograph. She was photographed with them, a schoolgirl figure in white blouse and black slacks amid a sea of beige uniforms. But if she was Tokyo Rose, and an American, then she was also probably a traitor. So, after the fun, she was arrested.

For a year she was kept in a military brig while her broadcasts were investigated. The authorities, finding nothing against her, concluded she was not Tokyo Rose and set her free. Others were not so easily robbed of their chimeras. A populist ranter and broadcaster, Walter Winchell, started a campaign to get her rearrested and retried. In 1948 she was indicted on eight counts of treason, one of which stuck: that in October 1944 “she did speak into a microphone concerning the loss of ships.” She was sentenced to ten years in prison and a fine of $10,000.

In fact, Miss Toguri's story was all innocence. She had gone to Japan for the first time in 1941 to visit a dying aunt; the outbreak of war had trapped her there, an “enemy alien” without money and almost without the language. She was forced, like many other Allied prisoners-of-war, to work in propaganda broadcasting. Unlike her mythical persona, however, she had delivered no threats and nothing to demoralise the troops. Her radio manner was jolly rather than sultry. She was “Orphan Ann”, after Little Orphan Annie, and her theme tune, “Strike up the Band”, had been the fight song of her alma mater, the University of California at Los Angeles.

An alien in Japan

Ostensibly she was working for the Japanese. But she and her mentor, Charles Cousens, a major in the Australian army, had found ways of undermining them. Odd pauses or silly asides (“You are liking, please?”) would make nonsense of chilling remarks. And the records Miss Toguri chose were often British rather than American, entertaining the troops without making them think miserably of home.

As a *nisei*, the daughter of first-generation Japanese immigrants, she looked thoroughly Japanese. Not so. She was American to her fingertips, a Girl Scout, keen on big-band music and a regular at her Methodist church. Her father, though he ran a Japanese-import store, had insisted on that identity, wanting his children to speak and write only English. Iva—the name she had embraced, casting off “Ikuko”—had set off for Japan in 1941 with her trunks full of American food, and her letters home wailed at the misery of three rice meals a day. Stuck in Tokyo, she was pestered by the military police to give up her American citizenship. She clung to it fiercely until in 1949, as part of her treason sentence, it was revoked by her own country.

The mistake was eventually acknowledged. Gerald Ford pardoned Miss Toguri on the last day of his presidency, in 1977: the first-ever pardon of any American convicted of treason. By then, she had been released early for good behaviour, had paid her fine and had moved to Chicago, to live obscurely and to help out sometimes in her father's Japanese-goods shop, selling bags of the hated rice to midwesterners.

Her pardon seemed an admission that she was not Tokyo Rose. But the American government still considered she was, even if wrongfully convicted. Hollywood, and the public, still thought so. And for many old servicemen “her” voice, and their dream of “her” face, still fill their memories of war in the Pacific, as real as the kamikaze aircraft plunging into the sea.

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Overview

Oct 5th 2006
From The Economist print edition

Business conditions in **Japan** are improving, said the central bank's quarterly Tankan survey. Big firms expect to increase capital spending in the next quarter. They also complained about a shortage of workers. The earnings of salaried employees in manufacturing fell by 0.6% in the year to August. The country's industrial production grew by 1.9% in August.

Manufacturing growth in **America** slowed in September. The Institute for Supply Management's index of manufacturing slipped to 52.9, from 54.5 in August, owing to the cooling housing market. Construction spending, though, picked up in August, by 0.3%, on the back of commercial and public projects. That month personal expenditure increased by $10.5 billion, or 0.1%, while personal income increased by $38.4 billion, or 0.3%.

Cheaper petrol and energy boosted the spirits of **America's consumers**. Confidence improved faster than expected, according to the final September reading of the University of Michigan's index of consumer sentiment. It rose to 85.4, from 82.0 in August.

In the **euro area** economic sentiment reached 109.3 in September, its highest level since February 2001 and one point higher than in August. Annual inflation in the euro area slowed in September, to 1.8% from 2.3% in August. Unemployment ticked up from 7.8% in July to 7.9% in August.

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Output, demand and jobs

Oct 5th 2006
From The Economist print edition

% change on year ago

	GDP latest		GDP qtr*	The Economist poll GDP forecasts 2006	2007	Industrial production latest		Retail sales (volume) latest		Unemployment % rate latest		year ago
Australia	+ 1.9	Q2	+ 1.3	+ 2.7	+ 3.2	– 1.0	Q1	+ 3.6	Q2	4.9	Aug	5.0
Austria	+ 3.0	Q2	+ 3.6	+ 2.6	+ 2.0	+ 7.9	Jul	+ 2.2	Jul	4.8	Sep	5.2
Belgium	+ 2.8	Q2	+ 3.1	+ 2.6	+ 2.0	+ 3.7	Jul	+ 1.6	Jul	13.0	Jul†	13.4
Britain	+ 2.6	Q2	+ 2.8	+ 2.6	+ 2.4	– 0.5	Jul	+ 4.3	Aug	5.5	Jul‡	4.7
Canada	+ 2.9	Q2	+ 2.0	+ 2.9	+ 2.6	+ 0.7	Jul	+ 5.5	Jun	6.5	Aug	6.8
Denmark	+ 2.4	Q2	+ 7.8	+ 2.7	+ 2.1	+ 5.6	Jul	+ 3.8	Aug	4.4	Jul	5.8
France	+ 2.6	Q2	+ 4.9	+ 2.3	+ 2.0	+ 1.3	Jul	+ 5.5	Jul	9.0	Aug	9.9
Germany	+ 2.4	Q2	+ 3.6	+ 2.3	+ 1.3	+ 4.7	Jul	+ 1.0	Aug	10.6	Sep§	11.7
Italy	+ 1.5	Q2	+ 1.9	+ 1.6	+ 1.2	– 0.2	Jul	– 0.3	Jun	7.0	Q2	7.8
Japan	+ 2.5	Q2	+ 1.0	+ 2.8	+ 2.1	+ 6.0	Aug	– 1.0	Jul	4.1	Aug	4.3
Netherlands	+ 2.8	Q2	+ 4.8	+ 2.7	+ 2.2	+ 1.9	Jun	+ 4.6	Jun	5.4	Aug††	6.6
Spain	+ 3.7	Q2	+ 3.8	+ 3.5	+ 2.8	+ 4.9	Aug	+ 1.1	Jul	7.8	Aug	8.6
Sweden	+ 5.1	Q2	+ 5.4	+ 4.4	+ 3.0	+ 1.5	Jul	+ 8.0	Aug	5.7	Aug†	6.5
Switzerland	+ 3.2	Q2	+ 3.0	+ 3.0	+ 2.0	+ 4.3	Q2	+ 2.1	Jul	3.1	Aug†	3.6
United States	+ 3.5	Q2	+ 2.6	+ 3.4	+ 2.4	+ 4.7	Aug	+ 2.5	Jul	4.7	Aug	4.9
Euro area	+ 2.4	Q2	+ 3.6	+ 2.5	+ 1.8	+ 3.2	Jul	+ 2.4	Aug	7.9	Aug	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 6.6	Q2	+ 7.6	na	na	+ 7.6	Aug	+ 5.1	Jul	7.8	Aug	8.2
Greece	+ 4.1	Q2	na	na	na	+ 1.4	Jul	+10.7	Jul	8.8	Q2	9.6
Iceland	+ 2.8	Q2	na	na	na	na		na		1.4	Jul†	2.0
Ireland	+ 5.0	Q2	+ 3.6	na	na	+ 8.4	Jul	+ 5.5	Jul	4.4	Aug	4.4
Luxembourg	+ 7.3	Q1	na	na	na	– 2.7	Jun	+ 2.3	Aug	4.1	Aug	4.1
New Zealand	+ 1.6	Q2	+ 1.7	na	na	– 0.7	Q1	+ 0.9	Q2	3.6	Q2	3.7
Norway	– 0.5	Q2	+ 1.9	na	na	– 2.9	Jul	+ 5.0	Aug	3.0	Aug††	4.8
Portugal	+ 0.9	Q2	+ 3.8	na	na	+ 5.1	Aug	+ 4.7	Jul	7.3	Q2†	7.2

*% change on previous quarter at an annual rate. †Not seasonally adjusted. ‡May-Jul; claimant count rate 3.0% in Aug.
§EU harmonised rate 8.2% in Jul. ††Jun-Aug.

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Prices and wages

Oct 5th 2006
From The Economist print edition

% change on year ago

	Consumer prices		The Economist poll consumer prices forecast		Producer prices		Wages/earnings	
	latest	year ago	2006	2007	latest	year ago	latest	year ago
Australia	+ 4.0 Q2	+ 2.5	+ 3.4	+ 2.8	+ 9.9 Q2	+ 6.9	+ 4.7 Q2	+ 5.8
Austria	+ 1.8 Aug	+ 2.0	+ 1.8	+ 1.7	+ 3.9 Aug	+ 0.9	+ 2.7 Aug	+ 2.3
Belgium	+ 1.2 Sep	+ 3.2	+ 2.0	+ 1.9	+ 5.9 Aug	+ 1.7	+ 2.1 Jul	+ 2.5
Britain	+ 2.5 Aug*	+ 2.4	+ 2.3	+ 2.2	+ 2.6 Aug	+ 3.0	+ 4.4 Jul†	+ 4.1
Canada	+ 2.1 Aug	+ 2.6	+ 2.4	+ 2.2	+ 3.6 Aug	– 0.3	– 0.4 Jun	+ 1.6
Denmark	+ 2.0 Aug	+ 2.2	+ 2.0	+ 2.0	+ 4.3 Aug	+ 5.0	+ 3.2 Q2	+ 2.9
France	+ 1.9 Aug	+ 1.8	+ 2.0	+ 1.7	+ 3.9 Jul	+ 3.3	+ 3.1 Q2	+ 3.0
Germany	+ 1.0 Sep	+ 2.5	+ 1.8	+ 2.3	+ 5.3 Aug	+ 1.9	– 0.5 Jul	+ 1.3
Italy	+ 2.2 Sep	+ 2.0	+ 2.2	+ 2.0	+ 6.6 Aug	+ 3.7	+ 2.9 Aug	+ 2.9
Japan	+ 0.9 Aug	– 0.3	+ 0.3	+ 0.5	+ 3.4 Aug	+ 1.8	– 0.6 Aug	– 2.7
Netherlands	+ 1.1 Sep	+ 1.8	+ 1.6	+ 1.7	+ 4.9 Aug	+ 5.1	+ 1.9 Aug	+ 0.8
Spain	+ 3.7 Aug	+ 3.3	+ 3.8	+ 3.0	+ 5.7 Aug	+ 4.9	+ 3.1 Q2	+ 3.4
Sweden	+ 1.6 Aug	+ 0.6	+ 1.4	+ 1.9	+ 3.9 Aug	+ 4.2	+ 2.5 Jul	+ 2.9
Switzerland	+ 0.8 Sep	+ 1.4	+ 1.3	+ 1.3	+ 3.1 Aug	+ 1.0	+ 1.0 2005	+ 0.9
United States	+ 3.8 Aug	+ 3.6	+ 3.5	+ 2.4	+ 3.7 Aug	+ 5.3	+ 3.9 Aug	+ 2.7
Euro area	+ 1.8 Sep	+ 2.6	+ 2.2	+ 2.1	+ 5.7 Aug	+ 4.0	+ 2.4 Q2	+ 2.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	+ 1.9 Aug	+ 1.0	na	na	+ 6.3 Aug	+ 3.8	+ 2.9 Q2	+ 3.7
Greece	+ 3.5 Aug	+ 3.7	na	na	+ 6.7 Aug	+ 5.5	na	na
Iceland	+ 7.6 Sep	+ 4.8	na	na	+11.4 Sep	+ 4.6	+10.6 Aug	+ 6.7
Ireland	+ 4.5 Aug	+ 2.3	na	na	+ 0.9 Aug	– 1.1	+ 2.2 Q1	+ 6.4
Luxembourg	+ 2.8 Aug	+ 2.7	na	na	+10.4 Jul	+ 5.5	+ 0.7 Jun	+ 2.0
New Zealand	+ 4.0 Q2	+ 2.8	na	na	+ 7.8 Q2	+ 4.7	+ 3.3 Q2	+ 2.6
Norway	+ 1.9 Aug	+ 1.9	na	na	+ 8.8 Aug	+19.9	+ 3.6 Q2	+ 3.8
Portugal	+ 2.0 Aug	+ 2.6	na	na	+ 4.9 Aug	+ 4.4	– 1.5 Jul	– 2.1

*RPI inflation rate 3.4% in Aug. †May-Jul.

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Economic forecasts

Oct 5th 2006
From The Economist print edition

October averages (previous month's, if changed)

	Real GDP, % change Low/high range		Real GDP, % change average		Consumer prices % increase		Current account % of GDP	
	2006	2007	2006	2007	2006	2007	2006	2007
Australia	2.5/2.9	2.7/4.0	2.7 (3.2)	3.2 (3.3)	3.4 (3.2)	2.8 (2.7)	-5.6(-5.7)	-5.3
Austria	2.4/2.9	1.7/2.3	2.6 (2.4)	2.0 (1.9)	1.8 (1.9)	1.7 (1.8)	0.8 (0.5)	0.8 (0.4)
Belgium	2.5/2.7	1.6/2.3	2.6	2.0 (1.9)	2.0 (2.1)	1.9	1.8 (1.5)	2.0 (1.6)
Britain	2.4/2.8	1.8/2.8	2.6	2.4 (2.5)	2.3 (2.2)	2.2 (2.1)	-2.7	-3.0 (-2.7)
Canada	2.6/3.1	2.0/3.0	2.9 (3.1)	2.6 (2.8)	2.4 (2.3)	2.2 (2.1)	1.5 (2.3)	1.0 (1.5)
Denmark	2.1/3.2	2.0/2.4	2.7	2.1 (2.3)	2.0	2.0	1.9 (2.0)	1.8
France	2.1/2.5	1.6/2.6	2.3 (2.2)	2.0	2.0	1.7	-1.8(-1.7)	-1.4
Germany	1.8/2.6	0.6/2.0	2.3 (2.0)	1.3	1.8	2.3	3.6	3.6
Italy	1.2/1.8	0.9/1.8	1.6 (1.5)	1.2	2.2	2.0 (1.9)	-1.8(-1.7)	-1.7 (-1.5)
Japan	2.6/3.0	1.6/3.1	2.8	2.1 (2.3)	0.3 (0.4)	0.5 (0.8)	3.5 (3.6)	3.5
Netherlands	2.4/3.0	1.5/2.9	2.7 (2.5)	2.2	1.6 (1.5)	1.7 (1.6)	6.3 (6.0)	6.0 (5.9)
Spain	3.2/3.7	2.5/3.0	3.5 (3.3)	2.8	3.8 (3.7)	3.0	-8.4(-8.0)	-8.0 (-7.7)
Sweden	3.8/4.7	2.6/3.3	4.4 (4.1)	3.0 (2.9)	1.4 (1.5)	1.9	6.5 (6.7)	6.0
Switzerland	2.7/3.5	1.5/2.4	3.0	2.0 (1.9)	1.3	1.3 (1.4)	13.0(12.7)	12.5 (12.1)
United States	3.1/3.6	1.6/3.0	3.4	2.4 (2.5)	3.5	2.4 (2.6)	-6.6(-6.7)	-6.6 (-6.7)
Euro area	2.2/2.8	1.5/2.5	2.5 (2.3)	1.8	2.2	2.1	-0.4	-0.2

Sources: ABN AMRO, Deutsche Bank, Economist Intelligence Unit, Goldman Sachs, HSBC Securities, KBC Bank, JPMorgan Chase, Morgan Stanley, Decision Economics, BNP Paribas, Citigroup, Scotiabank, UBS

Each month *The Economist* surveys a group of forecasters and calculates the average of their predictions for economic growth, inflation and current-account balances in 15 countries and the euro area. The table also shows the highest and lowest projections for growth. The previous month's figures, where they are different, are shown in brackets. The panel now expects America's GDP growth to slow to 2.4% in 2007, compared with September's prediction of 2.5%. The soothsayers think that the euro area will grow by 2.5% this year (up from 2.3% in September), then slow to 1.8% next year. Germany's growth in 2006 has been revised up from 2.0% to 2.3%. But Japan is now tipped to grow by 2.1% in 2007, down from September's prediction of 2.3%. The biggest upward revision is in the forecast for Sweden's growth: it is now expected to be 4.4% in 2006, the fastest of all the economies in the table.

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Money and interest rates

Oct 5th 2006
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Oct 4th 2006)					
				3-mth money market		2-year gov't bonds	10-year gov't bonds		corporate bonds
	narrow	broad		latest	year ago		latest	year ago	
Australia	+10.2	+11.2	Aug	6.19	5.63	5.82	5.50	5.37	6.72
Britain	+ 5.1	+13.7	Aug	5.02	4.53	4.95	4.52	4.26	5.55
Canada	+13.6	+ 6.9	Aug	4.16	2.90	3.88	3.96	3.93	5.18
Denmark	+ 8.2	+ 7.4	Aug	3.50	2.20	3.66	3.67	3.10	5.09
Japan	+ 2.3	+ 0.5	Aug	0.34	0.02	0.64	1.72	1.50	1.89
Sweden	+ 0.1	+13.7	Aug	2.55‡	1.52	3.31	3.61	3.06	3.73‡
Switzerland	– 1.3	+ 1.9	Aug	1.82	0.81	2.01	2.35	1.91	2.57
United States	– 0.6	+ 4.7	Aug	5.23	3.85	4.60	4.56	4.35	5.57
Euro area†	+ 7.2	+ 8.2	Aug	3.45	2.18	3.59	3.65	3.14	4.34

*Narrow: M1 except Britain notes and coin and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. ‡Sep 27th. Benchmarks: US 30-year 4.72%, Japan No. 282 1.72%. Central bank rates: US fed funds 5.25%, ECB refinancing 3.00%, BOJ overnight call 0.25%, BOE repo 4.75%. Sources: Bank of Canada, Commerzbank, Danske Bank, Global Insight, JPMorgan Chase, Lehman Brothers, Stockholmsbörsen, UBS, Westpac, Thomson Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Oct 5th 2006
From The Economist print edition

2000=100

	Sep 26th	Oct 3rd*	% change on one month	% change on one year
Dollar index				
All items	172.2	172.5	– 1.2	+ 28.9
Food	135.8	136.5	+ 0.9	+ 10.3
Industrials				
All	219.3	219.1	– 2.9	+ 49.1
Nfa†	135.2	136.2	– 4.6	+ 0.3
Metals	265.1	264.3	– 2.4	+ 72.7
Sterling index				
All items	137.8	138.4	– 1.1	+ 20.1
Euro index				
All items	125.6	125.2	– 0.7	+ 20.8
Yen index				
All items	187.0	188.7	+ 0.3	+ 33.0
Gold				
$ per oz	591.70	582.50	– 8.6	+ 25.1
West Texas Intermediate				
$ per barrel	61.12	58.65	–14.5	– 8.1

*Provisional. †Non-food agriculturals.

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Stockmarkets

Oct 5th 2006
From The Economist print edition

Market indices

	Oct 4th	2006 high	2006 low	% change on one week	% change on record high	% change on Dec 30th 2005 in local currency	% change on Dec 30th 2005 in $ terms
Australia (All Ordinaries)	5,101.5	5,318.2	4,708.8	+ 0.9	- 4.1	+ 8.3	+ 9.8
Austria (ATX)	3,774.5	4,344.4	3,324.1	- 1.0	- 13.1	+ 2.9	+10.7
Belgium (Bel 20)	4,084.1	4,084.1	3,445.1	+ 0.5	nil	+15.1	+23.8
Britain (FTSE 100)	5,966.5	6,132.7	5,506.8	+ 0.6	- 13.9	+ 6.2	+16.5
Canada (Toronto Composite)	11,618.1	12,487.3	10,904.3	- 1.1	- 7.0	+ 3.1	+ 6.7
Denmark (OMXCB)	380.6	395.5	325.0	+ 0.2	- 3.7	+ 3.5	+11.3
France (SBF 250)	3,699.1	3,755.6	3,244.2	+ 0.3	- 15.8	+12.1	+20.5
France (CAC 40)	5,256.6	5,312.2	4,615.4	+ 0.3	- 24.1	+11.5	+19.9
Germany (DAX)*	6,046.4	6,140.7	5,292.1	+ 0.9	- 25.0	+11.8	+20.3
Italy (S&P/MIB)	38,707.0	38,765.0	34,850.0	+ 1.0	- 22.8	+ 8.4	+16.6
Japan (Nikkei 225)	16,082.6	17,563.4	14,218.6	+ 0.8	- 58.7	- 0.2	- 0.2
Japan (Topix)	1,602.0	1,783.7	1,458.3	+ 0.7	- 44.5	- 2.9	- 2.9
Netherlands (AEX)	484.4	484.4	412.9	+ 0.5	- 31.0	+10.9	+19.3
Spain (Madrid SE)	1,415.1	1,415.1	1,156.8	+ 0.4	nil	+22.4	+31.6
Sweden (Affarsvarlden Gen)	327.7	333.7	275.2	+ 0.6	- 18.1	+11.7	+20.9
Switzerland (Swiss Market)	8,448.9	8,448.9	7,154.9	+ 0.4	nil	+11.4	+17.3
United States (DJIA)	11,850.6	11,850.6	10,667.4	+ 1.4	nil	+10.6	+10.6
United States (S&P 500)	1,350.2	1,350.2	1,223.7	+ 1.0	- 11.6	+ 8.2	+ 8.2
United States (NASDAQ Comp)	2,291.0	2,370.9	2,020.4	+ 1.2	- 54.6	+ 3.9	+ 3.9
Europe (FTSEurofirst 300)†	1,402.4	1,405.6	1,238.7	+ 0.4	- 17.7	+ 9.9	+18.3
Euro area (FTSE Euro 100)†	1,204.0	1,204.0	1,050.0	+ 0.4	- 22.3	+10.5	+18.9
World (MSCI)‡	1,381.2	1,406.3	1,243.9	+ 0.5	- 4.7	+ 9.8	+ 9.8
World bond market (Citigroup)††	648.0	653.7	612.1	- 0.3	- 2.8	+ 4.5	+ 4.5

*Total return index. †In euro terms. ‡Morgan Stanley Capital International index includes individual markets listed above plus eight others, in $ terms. ††Citigroup World Government Bond Index, total return, in $ terms.

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Trade, exchange rates and budgets

Oct 5th 2006
From The Economist print edition

	Trade balance*, $bn latest 12 months		Current-account balance $bn latest 12 mths		Current-account balance The Economist poll % of GDP, forecast 2006	Current-account balance The Economist poll % of GDP, forecast 2007	Exchange rate trade-weighted† 2000=100 Oct 4th	Exchange rate trade-weighted† 2000=100 year ago	Currency units per $ Oct 4th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2006‡
Australia	− 10.6	Aug	− 41.0	Q2	− 5.6	− 5.3	115.9	118.5	1.35	1.32	2.53	1.71	1.14	+ 0.9
Austria	− 1.6	Jul	+ 6.4	Q1	+ 0.8	+ 0.8	105.7§	104.8	0.79	0.84	1.48	–	0.67	− 1.9
Belgium	+ 15.7	Jul	+ 6.5	Jun	+ 1.8	+ 2.0	107.6§	106.5	0.79	0.84	1.48	–	0.67	− 0.4
Britain	−140.1	Jul	− 64.4	Q2	− 2.7	− 3.0	102.3	99.0	0.53	0.57	–	0.67	0.45	− 3.4
Canada	+ 58.8	Jul	+ 28.6	Q2	+ 1.5	+ 1.0	127.9	122.8	1.13	1.18	2.12	1.43	0.96	+ 2.2
Denmark	+ 8.2	Jul	+ 5.9	Jul	+ 1.9	+ 1.8	106.8	105.5	5.88	6.24	11.1	7.46	4.98	+ 3.3
France	− 33.2	Jul	− 36.3	Jul	− 1.8	− 1.4	108.4§	107.1	0.79	0.84	1.48	–	0.67	− 2.9
Germany	+185.8	Jul	+106.2	Jul	+ 3.6	+ 3.6	110.1§	108.5	0.79	0.84	1.48	–	0.67	− 3.1
Italy	− 23.9	Jul	− 34.3	Jul	− 1.8	− 1.7	108.0§	106.8	0.79	0.84	1.48	–	0.67	− 4.2
Japan	+ 78.0	Jul	+165.1	Jul	+ 3.5	+ 3.5	79.5	84.6	118	114	222	150	–	− 5.2
Netherlands	+ 39.0	Jul	+ 46.2	Q2	+ 6.3	+ 6.0	108.5§	107.2	0.79	0.84	1.48	–	0.67	− 0.5
Spain	−104.9	Jul	− 92.6	Jun	− 8.4	− 8.0	105.9§	105.1	0.79	0.84	1.48	–	0.67	+ 1.1
Sweden	+ 19.7	Aug	+ 24.1	Q2	+ 6.5	+ 6.0	97.3	96.1	7.35	7.78	13.9	9.33	6.23	+ 1.7
Switzerland	+ 8.2	Aug	+ 55.3	Q2	+13.0	+12.5	105.0	106.3	1.25	1.30	2.36	1.59	1.06	− 0.2
United States	−839.7	Jul	−838.1	Q2	− 6.6	− 6.6	84.2	86.4	–	–	1.88	1.27	0.85	− 3.6
Euro area	− 20.9	Jul	− 52.3	Jul	− 0.4	− 0.2	118.8	115.0	0.79	0.84	1.48	–	0.67	− 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*													
Finland	+ 10.9	Jul	+ 11.8	Jul	na	na	109.2§	108.0	0.79	0.84	1.48	–	0.67	+ 2.2
Greece	− 39.2	Jun	− 25.1	Jul	na	na	105.0§	104.1	0.79	0.84	1.48	–	0.67	− 3.0
Iceland	− 1.9	Aug	− 3.4	Q2	na	na	85.6**	100.9	68.6	61.5	129	87.0	58.1	+ 2.0
Ireland	+ 38.1	Jul	− 6.0	Q2	na	na	113.9§	111.9	0.79	0.84	1.48	–	0.67	− 0.3
Luxembourg	− 5.3	Jul	+ 4.2	Q2	na	na	107.6§	106.5	0.79	0.84	1.48	–	0.67	− 1.7
New Zealand	− 4.4	Aug	− 10.2	Q2	na	na	130.7	137.8	1.51	1.44	2.84	1.92	1.28	+ 4.6
Norway	+ 59.8	Aug	+ 56.5	Q2	na	na	104.7	110.6	6.62	6.59	12.5	8.40	5.61	+ 18.5
Portugal	− 22.2	Jun	− 16.7	Jul	na	na	105.9**	105.0	0.79	0.84	1.48	–	0.67	− 5.0

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †Bank of England except §IMF, July average. ‡OECD forecast. **IMF, June average.

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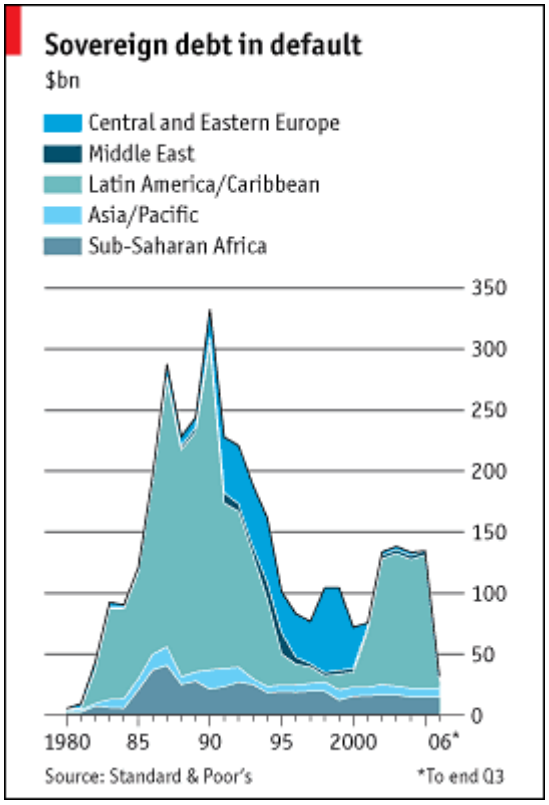
Sovereign debt in default

Oct 5th 2006
From The Economist print edition



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Overview

Oct 5th 2006
From The Economist print edition

India's GDP grew by 8.9% in the year to the second quarter, faster than expected, though more slowly than the blistering pace of 9.3% set in the year to the first quarter. Its consumer prices rose by 6.3% in August.

Turkey is still struggling to contain inflation. Consumer prices rose by 10.6% in the year to September, after rising by 10.3% in the year to August.

In its fifth cut this year, **Indonesia**'s central bank lowered its key interest rate by 50 basis points, to 10.75%. The country's industrial production rose by 12.2% in the year to July. Annual inflation fell for the fourth month in a row in September, though it still remains high at 14.5%.

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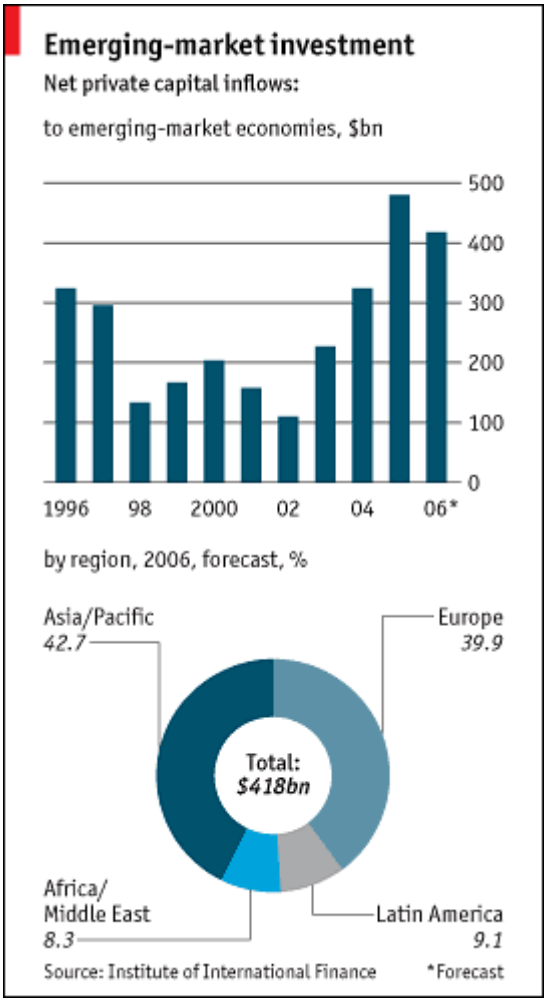
Emerging-market investment

Oct 5th 2006
From The Economist print edition

After weathering a turbulent spring, emerging economies will attract a net $418 billion in private capital in 2006, forecasts the Institute of International Finance (IIF), an association of banks. This would be the second-highest total in history, but still a big drop from the $480 billion recorded last year—and much less than the $490 billion of capital that is expected to flow in the other direction as the governments of emerging economies continue to add to their reserves. Foreigners are forecast to put more money into shares and direct investments than last year. But lending will fall.



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Economy

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	% change on year ago						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+11.3	Q2	+15.7	Aug	+ 1.3	Aug	+135.9	Aug	+160.8	2005	954.5	Jul
Hong Kong	+ 5.2	Q2	+ 5.3	Q2	+ 2.5	Aug	−14.9	Aug	+18.6	Q2	128.9	Aug
India	+ 8.9	Q2	+12.4	Jul	+ 6.3	Aug	−41.8	Aug	−13.2	Q2	158.0	Aug
Indonesia	+ 5.2	Q2	+12.2	Jul	+14.5	Sep	+36.4	Aug	+ 3.8	Q1	40.4	Aug
Malaysia	+ 5.9	Q2	+ 7.3	Jul	+ 3.3	Aug	+28.0	Aug	+20.0	Q2	79.0	Aug
Pakistan	+ 6.6	2006†	+13.0	Jul§	+ 8.9	Aug	−12.5	Jul	− 5.0	Q2	11.6	Jun
Philippines	+ 5.5	Q2	−10.4	Jul	+ 5.7	Sep	− 4.1	Jul	+ 2.9	Mar	18.6	Aug
Singapore	+ 8.1	Q2	+ 5.5	Aug	+ 0.7	Aug	+32.6	Aug	+38.3	Q2	130.7	Aug
South Korea	+ 5.3	Q2	+10.6	Aug	+ 2.4	Sep	+15.7	Sep	+ 5.8	Aug	227.0	Aug
Taiwan	+ 4.6	Q2	+ 4.8	Aug	− 0.6	Aug	+20.3	Aug	+20.6	Q2	261.0	Aug
Thailand	+ 4.9	Q2	+ 7.4	Aug	+ 2.7	Sep	− 1.9	Aug	+ 3.4	Aug	57.7	Aug
Argentina	+ 7.9	Q2	+ 7.6	Aug	+10.4	Sep	+11.3	Aug	+ 7.4	Q2	25.1	Jul
Brazil	+ 1.2	Q2	+ 3.2	Jul	+ 3.8	Aug	+46.3	Sep	+13.8	Aug	68.8	Aug
Chile	+ 4.5	Q2	+ 1.9	Jul	+ 2.8	Sep	+18.5	Aug	+ 2.2	Q2	16.3	Aug
Colombia	+ 6.0	Q2	+13.6	Jul	+ 4.6	Sep	+ 0.7	Jul	− 2.2	Q2	14.9	Aug
Mexico	+ 4.7	Q2	+ 5.8	Jul	+ 3.5	Aug	− 4.2	Aug	− 0.6	Q2	83.0	Jul
Peru	+ 9.0	Jul	+ 5.6	Jul	+ 2.0	Sep	+ 6.9	Jul	+ 1.3	Q2	14.3	Aug
Venezuela	+ 9.2	Q2	+14.3	Jun	+15.3	Sep	+37.2	Q2	+29.5	Q2	23.8	Jun
Egypt	+ 5.9	Q1	+ 4.0	2005†	+ 8.9	Aug	−11.2	Q1	+ 2.1	Q1	23.2	Aug
Israel	+ 6.2	Q2	+13.4	Jul	+ 2.2	Aug	− 7.9	Aug	+ 5.8	Q2	28.1	Aug
Saudi Arabia	+ 6.6	2005‡	na		+ 2.2	Jul	+126.5	2005	+90.7	2005	22.8	Jul
South Africa	+ 3.6	Q2	+ 5.8	Jul	+ 5.4	Aug	− 8.2	Aug	−13.3	Q2	21.9	Aug
Czech Republic	+ 6.2	Q2	+11.8	Jul	+ 3.1	Aug	+ 1.6	Jul	− 3.8	Q2	30.7	Aug
Hungary	+ 3.8	Q2	+12.2	Jul	+ 3.5	Aug	− 3.3	Jul	− 7.6	Q2	20.8	Aug
Poland	+ 5.5	Q2	+12.5	Aug	+ 1.6	Aug	− 3.2	Jul	− 4.9	Jul	46.7	Aug
Russia	+ 7.4	Q2	+ 5.6	Aug	+ 9.7	Aug	+139.6	Jul	+91.4	Q2	252.2	Aug
Turkey	+ 7.5	Q2	+ 9.5	Jul	+10.6	Sep	−50.6	Aug	−29.6	Jul	57.0	Jul
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Estonia	+12.0	Q2	+ 7.6	Jul	+ 5.0	Aug	− 2.7	Jun	− 1.8	Jul	2.2	Jul
Latvia	+10.9	Q2	+ 3.9	Jul	+ 6.8	Aug	− 3.9	Jul	− 2.8	Jul	3.4	Jul
Lithuania	+ 7.7	Q2	na		+ 4.2	Aug	− 4.2	Jul	− 2.2	Jun	4.2	Jul
Slovakia	+ 6.2	Q2	+ 8.3	Jul	+ 5.1	Aug	− 3.0	Jul	− 4.6	May	12.4	Jul
Slovenia	+ 4.9	Q2	+ 7.1	Jul	+ 3.2	Aug	− 1.8	Jul	− 0.6	Jul	8.1	Jun

*Excluding gold, except Singapore and China; IMF definition. †Year ending June. ‡Economist Intelligence Unit estimate. §New series.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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Financial markets

Oct 5th 2006
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Oct 4th		Dec 30th 2005	
	Oct 4th	year ago	Oct 4th	% a year		one week	in local currency	in $ terms
China	7.90	8.09	14.9	3.00	1,840.3	+1.5	+ 50.7	+ 53.9
Hong Kong	7.79	7.76	14.7	4.29	17,629.2	+0.6	+ 18.5	+ 17.9
India	45.7	44.2	86.1	6.59	12,204.0	- 1.3	+ 29.9	+ 27.8
Indonesia	9,220	10,030	17,370	11.46	1,537.1	+0.9	+ 32.2	+ 41.1
Malaysia	3.69	3.77	6.96	3.81	964.1	- 0.2	+ 7.1	+ 9.7
Pakistan	60.6	59.7	114	10.14	10,743.6	+3.4	+ 12.4	+ 11.0
Philippines	50.0	55.8	94.2	7.69	2,486.8	- 2.7	+ 18.6	+ 25.8
Singapore	1.58	1.69	2.99	3.41	2,602.9	+1.8	+ 10.9	+ 16.3
South Korea	949	1,040	1,788	4.61	1,352.0	- 0.6	- 2.0	+ 4.4
Taiwan	33.1	33.2	62.4	1.84	6,875.0	- 1.0	+ 5.0	+ 4.1
Thailand	37.6	41.0	70.8	5.35	688.0	- 0.7	- 3.6	+ 5.1
Argentina	3.10	2.92	5.85	10.19	1,641.4	- 0.2	+ 6.4	+ 3.7
Brazil	2.17	2.28	4.09	14.16	37,749.0	+4.6	+ 12.8	+ 21.4
Chile	535	528	1,008	5.16	10,819.0	+1.7	+ 17.5	+ 12.5
Colombia	2,405	2,294	4,532	6.29	9,369.0	+2.7	- 1.5	- 6.4
Mexico	11.1	10.7	20.8	7.05	22,106.0	+1.6	+ 24.2	+ 19.5
Peru	3.25	3.36	6.12	4.60	9,919.9	- 4.1	+106.6	+118.2
Venezuela	2,807§	2,799§	5,287	10.13	36,019.9	+3.1	+ 76.6	+ 62.7
Egypt	5.74	5.75	10.81	9.29	55,805.1	- 2.1	+ 0.8	+ 0.8
Israel	4.27	4.60	8.04	5.59	860.1	+2.7	+ 3.9	+ 12.1
Saudi Arabia	3.75	3.75	7.07	5.25	10,832.8	- 2.9	- 35.2	- 35.2
South Africa	7.95	6.53	15.0	8.30	22,367.2	+0.5	+ 23.6	- 1.4
Czech Republic	22.3	24.8	42.0	2.63	1,453.4	+0.3	- 1.3	+ 9.1
Hungary	217	209	408	8.23	21,948.0	- 1.1	+ 5.6	+ 4.4
Poland	3.10	3.28	5.84	4.23	44,267.5	+0.6	+ 24.3	+ 30.6
Russia	26.8	28.6	50.5	11.50	1,521.0‡	+0.1	+ 26.0	+ 35.1
Turkey	1.51	1.35	2.84	20.37	36,389.7	- 1.2	- 8.5	- 18.0
EM (MSCI)*	1.00	1.00	1.88	na	774.4	- 0.2	+ 9.6	+ 9.6
EMBI+†	1.00	1.00	1.88	na	392.9	+0.4	+ 6.6	+ 6.6

*Emerging Mkts. †JPMorgan Chase's Emerging Mkts Bond Index Plus. ‡In $ terms. §Trading market value.

Sources: National statistics offices, central banks and stock exchanges; Thomson Datastream; Reuters; WM/Reuters; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; Bank Leumi le-Israel; Standard Bank Group

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